United Nations Commission on International Trade Law

YEARBOOK

Volume VIII: 1977

UNITED NATIONS
New York, 1978

NOTE

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

A/CN.9/SER.A/1977

UNITED NATIONS PUBLICATION

Sales No. E.78.V.7

Price: $U.S. 16.00

(or equivalent in other currencies)

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INTRODUCTION

This is the eighth volume in the series of Yearbooks of the United Nations Commission on International Trade Law (UNCITRAL).[1] This volume covers the period from June 1976 to the end of the Commission's tenth session in June 1977.

The present volume consists of three parts. Part One completes the presentation of documents relating to the Commission's report on the work of its ninth session by including material (such as action by the General Assembly) which was not available when the manuscript of the seventh volume was prepared. Part One also contains the Commission's report on the work of its tenth session which was held in Vienna from 23 May to 17 June 1977.

Part Two reproduces most of the documents considered at the tenth session of the Commission.

Part Three contains a bibliography of recent writings related to the work of UNCITRAL and a check list of UNCITRAL documents.

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[1] The volumes published to date are referred to respectively as follows: *Yearbook of the United Nations Commission on International Trade Law* [abbreviated herein as Yearbook . . . (year)]. *Volume I: 1968-1970* (United Nations publication, Sales No. E.71.V.1); *Volume II: 1971* (United Nations publication, Sales No. E.72.V.4); *Volume III: 1972* (United Nations publication, Sales No. E.73.V.6); *Volume IV: 1973* (United Nations publication, Sales No. E.74.V.3); *Volume V: 1974* (United Nations publication, Sales No. E.75.V.2); *Volume VI: 1975* (United Nations publication E.76.V.5) and *Volume VII: 1976* (United Nations publication, Sales No. E.77.V.1).

I. THE NINTH SESSION (1976); COMMENTS AND ACTION WITH RESPECT TO THE COMMISSION'S REPORT

A. United Nations Conference on Trade and Development (UNCTAD): extract from the report of the Trade and Development Board (First part of the sixteenth session)*

B. *Progressive development of the law of international trade: ninth annual report of the United Nations Commission on International Trade Law (agenda item 6 (b))*

268. At its 455th meeting, on 19 October 1976, the Board took note with appreciation of the report of the United Nations Commission on International Trade Law on the work of its ninth session,[80] which has been circulated under cover of document TD/B/617.

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* *Official Records of the General Assembly, Thirty-first Session, Supplement No. 15* (A/31/15), volume II, Chapter V: Other particular matters in the field of trade and development.

[80] *Official Records of the General Assembly, Thirty-first Session, Supplement No. 17* (A/31/17).

B. General Assembly: report of the Sixth Committee (A/31/390)*

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INTRODUCTION

1. At its 4th plenary meeting, on 24 September 1976, the General Assembly decided to include in the agenda of its thirty-first session the item entitled "Report of the United Nations Commission on International Trade Law on the work of its ninth session" and to allocate it to the Sixth Committee.

2. The Sixth Committee considered the item at its 32nd to 41st meetings, from 29 October to 11 November 1976 and at its 68th meeting, on 9 December.

3. At the 32nd meeting, Mr. L. H. Khoo (Singapore), Chairman of the United Nations Commission on International Trade Law (UNCITRAL) at its ninth session, introduced the Commission's report on the work of that session (A/31/17).[1] The Sixth Committee

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* 10 December 1976. *Official Records of the General Assembly, Thirty-first Session, Annexes*, agenda item 108.

[1] [Yearbook ... 1976, part one, II, A.] The presentation of the report was made pursuant to a decision by the Sixth Committee at its 1096th meeting, on 13 December 1968 (see *Official Records of the General Assembly, Twenty-third Session, Annexes*, agenda item 88, document A/7408, para. 3 [Yearbook ... 1968-1970, part two, I, B, 2]).

also had before it a note by the Secretary-General (A/C.6/31/5 and Add.1) setting forth the comments on the Commission's report by the Trade and Development Board of the United Nations Conference on Trade and Development (UNCTAD).

4. At the 68th meeting, the Rapporteur of the Sixth Committee raised the question whether the Committee wished to include in its report to the General Assembly on the item a summary of the main trends that had emerged during the debate on the Commission's report. After referring to General Assembly resolution 2292 (XXII) of 8 December 1967, concerning publications and documentation of the United Nations, the Rapporteur informed the Committee of the financial implications of the question. At the same meeting, the Sixth Committee decided that, in view of the nature of the subject-matter, the report on agenda item 108 should include a summary of the main trends of opinion that were expressed during the debate.

Proposals

5. At the same meeting, three draft resolutions were introduced on the item. Two of these (A/C.6/31/L.13 and A/C.6/31/L.14 and Corr.1) were introduced by the representative of the Philippines on behalf of the respective sponsoring delegations. The sponsors of draft resolution A/C.6/31/L.13 were Australia, Austria, the Netherlands, Nigeria, the Philippines, Singapore, Sri Lanka, Sweden, the United Kingdom of Great Britain and Northern Ireland and the United States of America, later joined by Finland, France, Greece, Indonesia, Italy, Japan and Kenya. The sponsors of draft resolution A/C.6/31/L.14 and Corr.1 were Austria, Czechoslovakia, Nigeria, Paraguay, the Philippines, Singapore, Sri Lanka and Yugoslavia, later joined by Finland, Indonesia and Kenya. The third draft resolution (A/C.6/31/L.17/Rev.1) was introduced by the representative of Sri Lanka on behalf of Australia, Austria, Guyana, Iran, Mexico, Nigeria, Pakistan, Paraguay, the Philippines, Singapore, Sri Lanka, Trinidad and Tobago and Tunisia, later joined by Finland and Kenya (*For the text of the draft resolutions, see para. 49 below*).

Debate

6. The major trends of opinion expressed in the Sixth Committee on the report of UNCITRAL on the work of its ninth session are summarized in sections A to K below. Sections A and B deal with general observations on the role and functions of the Commission and on its working methods, while sections C to K are devoted to the Committee's discussion on the specific topics considered by the Commission at its ninth session, as follows: international sale of goods (sect. C); international payments (sect. D); international legislation on shipping (sect. E); international commercial arbitration (sect. F); multinational enterprises (sect. G); liability for damage caused by products intended for or involved in international trade (sect. H); training and assistance in the field of international trade law (sect. I); future work (sect. J); and other business (sect. K).

A. *General observations*

7. Representatives were unanimous in stressing the importance of the Commission's work. It was the general view that the unification, harmonization and progressive development of international trade law serve to promote not only the development of equitable commercial and economic relations between developing and developed countries and between countries with differing social and economic systems but also the orderly growth of international trade. It was further observed by some representatives that since international commercial relations themselves played an important role in world peace and stability, any activity, such as UNCITRAL's work, which facilitated those relations could not but itself contribute to such peace and stability.

8. Representatives were also unanimous in expressing their delegations' satisfaction with the progress made by the Commission and by its Working Groups in carrying out the Commission's work programme and commended especially the work done in producing the draft Convention on the Carriage of Goods by Sea and the UNCITRAL Arbitration Rules.

9. Many representatives urged the Commission to take account in its future work of the special needs of developing countries and also of the General Assembly resolutions regarding the establishment of a new international economic order.

B. *Working methods of the United Nations Commission on International Trade Law*

10. All representatives who touched on the matter commented favourably on the working methods followed by the Commission. Representatives noted particularly with approval the procedure whereby the Commission circulated draft legal texts prepared by its working groups to Governments and to interested international organizations for comment before adopting a final (draft) text. It was the general view that that practice enabled the Commission to benefit from the broadest range of views in its preparation of texts.

11. Also commended by representatives was the Commission's practice, through its secretariat, of consulting and collaborating with other United Nations bodies and with intergovernmental organizations and international and regional non-governmental organizations which were engaged in work on topics of interest to the Commission. Representatives expressed the hope that the Commission would continue that very worthwhile practice.

12. A number of representatives recalled favourably the fact that it was the practice of the Commission and its working groups to proceed by consensus and to vote only if no consensus could be reached. In commending that decision-making process, several representatives stressed that it ensured that the uniform rules derived from the Commission's work would be generally acceptable.

C. *International sale of goods*

13. Many representatives stressed the importance to international trade of the law governing international sales and consequently the value of the work undertaken by the Commission's Working Group on the International Sale of Goods in revising the 1964 Hague Uniform Law on the International Sale of Goods (ULIS). Representatives expressed their satisfaction with the progress made in that regard, noting especially the fact that the

Working Group had been able to complete work on a text of a draft convention which would be given final consideration by the Commission at its tenth session.

14. With regard to the draft text itself, many representatives, though reserving their delegations' final position pending detailed study of its provisions, offered their preliminary assessment that the draft represented an improvement in many respects on the present ULIS. It was, however, also observed by some representatives that there were still some unresolved questions with regard to certain provisions of the draft text, while other representatives expressed some reservations on certain other provisions as they now stood. The general expectation was voiced nevertheless that those problems would be resolved when the Commission considered the draft text at its tenth session.

15. Many representatives welcomed the decision by the Commission to commence work on uniform rules on the formation and validity of contracts for the international sale of goods. Although a number of representatives expressed the view that ideally the rules on formation and validity along with the revised ULIS should form part of a single sales convention, most representatives who addressed the issue thought that such an approach might cause great delay in adopting a convention and accordingly favoured the approach under which the two matters were to be treated separately and at different conferences of plenipotentiaries.

D. *International payments*

16. Several representatives noted that once the uniform law on international bills of exchange and international promissory notes being prepared by the Working Group on International Negotiable Instruments became part of the law of international trade it would represent a major contribution to international commercial transactions.

17. Some representatives expressed the hope that the Working Group would before long take up work on international cheques. Attention was also drawn to the need for the Working Group to maintain flexibility in its approach to the problems of international payments so as to take full account of continuing developments in that field, particularly those relating to electronic methods of data transmission and fund transfers.

E. *International legislation on shipping*

18. Representatives were unanimous in commending the work of the Commission and of its Working Group on International Legislation on Shipping in producing a draft Convention on the Carriage of Goods by Sea (A/31/17, para. 45) designed to replace the 1924 Brussels Convention on Bills of Lading and the 1968 Brussels Protocol thereto. All representatives who spoke favoured the convening at an early date of a conference of plenipotentiaries to conclude a new convention on the basis of the draft convention, though some emphasized that Governments ought to be given sufficient time first to study the text of the draft.

19. While reserving for a later period their final position on the substance of the provisions embodied in the draft convention, many representatives none the less expressed their preliminary views on the matter. Most representatives saw the draft convention as a significant improvement on the regulatory régime established by the Brussels Convention and the Brussels Protocol. It was noted in particular that the new draft reflected more accurately technological developments in modern maritime transport and would create a more equitable balance between the interests of the carrier, on the one hand, and those of the cargo-owner, on the other.

20. Other aspects of the new draft which received favourable notice by representatives were the provision on scope of application, which contemplated a convention of much wider scope than the Brussels Convention, the provisions relating to liability for delay, the limitation (prescription) provision and the provisions on jurisdiction (article 21), which permitted the bringing of action in one of a number of alternative jurisdictions.

21. Several representatives expressed reservations with regard to the provision on liability for loss caused by fire (article 5, paragraph 4). It was the view of those representatives that the burden in such a case to prove the carrier's fault or neglect should not be on the claimant, as that would be far too difficult, and often impossible; rather, as was the case with loss from other causes, it should be for the carrier to show that he had not been at fault or otherwise negligent. A number of representatives pointed out, however, that article 5 as a whole had been the subject of long and arduous debate within the Commission and its Working Group and that the present draft should, therefore, be seen as a necessary compromise between the interests otherwise at conflict with respect to the matter therein regulated. The fear was further expressed that some of the changes proposed might have an adverse effect on freight and other costs.

22. Some representatives pointed out the problems of State sovereignty raised by State-owned commercial vessels in the context especially of the acquisition of jurisdiction over such vessels by a foreign court through legal arrest, as contemplated in article 21, paragraph 2(*a*) of the draft Convention. A number of representatives also expressed their delegations' preferences with regard to the contents of article 6 (limitation of carrier's liability) and of the Final Clauses. The prevailing sentiment among representatives, however, was that those questions were best left for resolution at the conference of plenipotentiaries.

23. In welcoming the work done so far on shipping legislation, representatives of developing countries noted that most of the carrying capacity in maritime transport was controlled by developed countries and that it was therefore desirable to ensure that the economic interests of developing countries would be duly taken into account in any convention on the carriage of goods by sea. Accordingly, those representatives stressed the need to look beyond the legal aspects of the carriage of goods by sea to its economic and shipping trade aspects.

24. Several representatives commented on the valuable contribution made by UNCTAD to the work on shipping legislation and expressed the hope that the collaboration which existed between the Commission's secretariat and the secretariat of UNCTAD would extend to secretariat services at the Conference of Plenipotentiaries.

F. *International commercial arbitration*

25. Stressing the crucial role played by arbitration in the settlement of disputes arising in international com-

merce, representatives generally welcomed the issuance of the UNCITRAL Arbitration Rules (A/31/17, para. 57). The Rules, it was stated, would not only facilitate *ad hoc* commercial arbitration for parties who choose them, but would by the mere fact of existence as UNCITRAL rules encourage resort to arbitral proceedings in the resolution of commercial disputes.

26. Representatives uniformly associated themselves with the Commission's decision to invite the General Assembly to recommend the use of the UNCITRAL Arbitration Rules in the settlement of disputes arising in the context of international commercial relations, particularly by reference to the UNCITRAL Arbitration Rules in an arbitration clause in commercial contracts.

27. Commenting on the UNCITRAL Arbitration Rules themselves, many representatives expressed satisfaction with their optional character. It was noted with approval that the Rules had been produced by the Commission, not in the usual form of a draft convention, but in the much simpler and less costly form of model rules for parties, requiring no international convention or national legislative enactment. It was suggested that that was a method which the Commission might possibly wish to employ with respect to its future projects, whenever appropriate.

28. The view was expressed that it might have been advisable for the Commission to have consulted Governments before final formulation of the UNCITRAL Arbitration Rules inasmuch as Governments themselves often were parties to commercial arbitration. It was pointed out, however, that the Rules, though intended merely for optional use by parties, had been formulated only after extensive consultations with the regional commissions and with centres of international commercial arbitration. It was also observed that the Rules had been considered at the seventeenth session of the Asian-African Legal Consultative Committee, held at Kuala Lumpur from 30 June to 5 July 1976, at which the decision was taken to recommend the use of the UNCITRAL Arbitration Rules in the settlement of disputes arising in the context of international commercial relations.[2]

29. It was recalled that the Asian-African Legal Consultative Committee had noted the absence of major centres of arbitration in developing countries and the hope was expressed that Governments and commercial interests would assist in the establishment of regional centres of arbitration in developing countries.

30. A number of representatives, noting that the UNCITRAL Arbitration Rules were intended for use in *ad hoc* arbitration only, expressed the hope that even arbitral institutions might find them useful.

G. *Multinational enterprises*

31. Many representatives, drawing attention to the impact of the activities of multinational enterprises on the economy of their host countries, particularly developing countries, stressed the need for international regulation of such activities. It was noted that the Commission could play an important role in that connexion.

32. Most representatives who spoke on the subject recalled favourably the Commission's decision taken at its eighth session[3] to maintain the subject of multinational enterprises on its agenda. Some representatives suggested that the Commission should take the initiative in embarking on work on the subject. Others, however, pointed out the difficulties which could be created by such a step inasmuch as the Commission on Transnational Corporations had been created specifically to deal with those matters.

33. Some representatives noted that the Commission had already communicated to the Commission on Transnational Corporations its readiness to consider any issues of a legal nature that the latter might wish to refer to it, and urged collaboration between the two Commissions.

H. *Liability for damage caused by products intended for or involved in international trade*

34. Several representatives commented favourably on the Commission's decision[4] to explore the desirability and feasibility of elaborating uniform rules on the subject applicable on a global level. It was noted in that connexion that the Commission expected to have before it at its tenth session a report of the Secretary-General which should aid it in its decision as to a future course of action.

35. Several representatives drew attention to a number of regional unification schemes already in progress in parts of the world and stressed the urgency of action on a global level which, according to some, was the preferred solution.

I. *Training and assistance in the field of international trade law*

36. The Committee was unanimous in stressing the great importance of that aspect of the Commission's work. It was observed that the Commission's training and assistance programme was not only a good way of publicizing its work and generating world-wide interest in the field of international trade law, but also had the important objective of helping to create expertise in the field globally. For that reason, it was further observed, the Commission's training and assistance activities were an essential complement to its work of elaborating uniform rules inasmuch as such rules could only be effectively implemented world-wide if there were available in each State persons who were familiar with the rules.

37. Many representatives commented favourably on specific aspects of the Commission's training and assistance programme during the past year. Appreciation was expressed, especially by representatives of developing countries, to Governments which had contributed materially towards that programme.

38. A number of representatives noted with appreciation the arrangement whereby the United Nations Institute for Training and Research (UNITAR) had agreed to include, whenever feasible, the subject of international trade law in the curriculum of its regional seminars in international law. It was urged in that connexion that that UNITAR programme be extended to all parts of the world.

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[2] See A/CN.9/127, annex (reproduced in the present volume, part two, III).

[3] See *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17*, para. 94.

[4] *Ibid.*, para. 103.

39. Unanimous support was expressed for the projected Second UNCITRAL Symposium on International Trade Law scheduled to take place in 1977 in connexion with the tenth session of the Commission. Noting that lack of sufficient funds was threatening cancellation of the symposium, many representatives thanked those Governments which had already made or pledged voluntary contributions towards sponsoring candidates from developing countries and urged other Governments in a position to do so to give financial support to the cause.

40. The suggestion was made that consideration should be given to financing the Commission's training and assistance programme, of such importance to developing countries, out of the regular budget of the United Nations rather than to continue relying on voluntary contributions whose availability could not be assured.

41. The representative of Belgium, discussing the Commission's programme of training and assistance in the field of international trade law, announced that his Government planned to renew for 1977 its two fellowships in international trade law tenable at an institution of higher learning in that country.

J. *Future work*

42. Most representatives, noting with satisfaction the fact that the Commission had completed or soon would complete work on the items on its priority list of projects and was in the process of reviewing its long-term programmes, stressed the importance of such long-term planning.

43. Representatives also commended the Commission's efforts to solicit suggestions from Governments and interested international organizations with regard to its long-term work programme and urged Governments to come forward with their views.

44. A number of suggestions were made by representatives as to items for possible inclusion in the Commission's work programme. Among them were measures to implement the principles of the new international economic order in the field of international trade law and measures designed to give greater protection to the interests of developing countries in international trade; the problems, when States or State organs engaged in commercial activities, of distinguishing between the State as a trading entity and the State as a sovereign entity; legal aspects of multimodal transportation; and contracts for various forms of economic relations other than sales contracts.

45. There was general satisfaction with the agenda and arrangements for the tenth session of the Commission. Representatives noted with appreciation that the tenth session of the Commission would be held in Vienna, at the invitation of the Government of Austria, and thanked that Government for its hospitality.

K. *Other business*

46. Representatives who spoke unanimously endorsed the recommendation of the Commission, contained in paragraph 74 of its report, that States Members of the United Nations, but not members of the Commission, be allowed, where they so request, to attend meetings of the Commission and its working groups as observers.

47. Representatives also expressed support for the recommendation of the Commission, contained in paragraph 76 of its report, regarding the commencement and expiration of the term of office of members of the Commission.

Decision

48. At the same meeting, the Sixth Committee adopted by consensus draft resolutions A/C.6/31/L.13, A/C.6/31/L.14 and Corr.1 and A/C.6/31/L.17/Rev.1.

Recommendations of the Sixth Committee

49. The Sixth Committee recommends to the General Assembly the adoption of the following draft resolutions:

[Texts not reproduced in this section. The draft resolutions were adopted without change as General Assembly resolutions 31/98, 31/99 and 31/100. See section C below.]

C. General Assembly resolutions 31/98, 31/99 and 31/100 of 15 December 1976

31/98. Arbitration Rules of the United Nations Commission on International Trade Law

The General Assembly,

Recognizing the value of arbitration as a method of settling disputes arising in the context of international commercial relations,

Convinced that the establishment of rules for *ad hoc* arbitration that are acceptable in countries with different legal, social and economic systems would significantly contribute to the development of harmonious international economic relations,

Bearing in mind that the Arbitration Rules of the United Nations Commission on International Trade Law have been prepared after extensive consultation with arbitral institutions and centres of international commercial arbitration,

Noting that the Arbitration Rules were adopted by the United Nations Commission on International Trade Law at its ninth session[1] after due deliberation,

1. *Recommends* the use of the Arbitration Rules of the United Nations Commission on International Trade Law in the settlement of disputes arising in the context of international commercial relations, particularly by reference to the Arbitration Rules in commercial contracts;

2. *Requests* the Secretary-General to arrange for the widest possible distribution of the Arbitration Rules.

99th plenary meeting

[1] *Official Records of the General Assembly, Thirty-first Session, Supplement No. 17* (A/31/17), chap. V, sect. C. (Yearbook ... 1976, part one, II, A).

31/99. Report of the United Nations Commission on International Trade Law

The General Assembly,

Having considered the report of the United Nations Commission on International Trade Law on the work of its ninth session,[2]

Recalling its resolution 2205 (XXI) of 17 December 1966, by which it established the United Nations Commission on International Trade Law and defined the object and terms of reference of the Commission, and its resolution 3108 (XXVIII) of 12 December 1973, by which it increased the membership of the Commission, as well as its previous resolutions concerning the reports of the Commission on the work of its annual sessions,

Recalling also its resolutions 3201 (S-VI) and 3202 (S-VI) of 1 May 1974, 3281 (XXIX) of 12 December 1974 and 3362 (S-VII) of 16 September 1975,

Reaffirming its conviction that the progressive harmonization and unification of international trade law, in reducing or removing legal obstacles to the flow of international trade, especially those affecting the developing countries, would significantly contribute to universal economic cooperation among all States on a basis of equality and to the elimination of discrimination in international trade and, thereby, to the well-being of all peoples,

Having regard for the need to take into account the different social and legal systems in harmonizing the rules of international trade law,

Noting with appreciation that the United Nations Commission on International Trade Law has completed, or soon will complete, work on many of the priority items included in its programme of work,

Noting further that, under resolutions 2205 (XXI) and 3108 (XXVIII), a State elected as a member of the United Nations Commission on International Trade Law takes office on 1 January of the year following its election, and that its term of office expires on 31 December of the last year of the period for which it was elected,

Bearing in mind that much of the substantive work of the United Nations Commission on International Trade Law is carried out in its Working Groups which usually meet during the months of January and February prior to the regular annual session of the Commission, and that inconvenience is caused to the work of the Commission because vacancies occurring in the membership of Working Groups as at 31 December cannot be filled until the next regular annual session of the Commission,

Taking into account the fact that Governments of Member States which are not members of the United Nations Commission on International Trade Law have on occasion expressed the wish to attend sessions of the Commission and of its Working Groups as observers and the opinion of the Commission expressed in paragraph 74 of its report on the work of its ninth session that it is in the interest of the Commission's work that such States, not members of the Commission, be given the opportunity to participate in its work as observers,

Bearing in mind that the Trade and Development Board of the United Nations Conference on Trade and Development, at its sixteenth session, took note with appreciation of the report of the United Nations Commission on International Trade Law,[3]

1. *Takes note with appreciation* of the report of the United Nations Commission on International Trade Law on the work of its ninth session;

2. *Commends* the United Nations Commission on International Trade Law for the progress made in its work and for its efforts to enhance the efficiency of its working methods;

3. *Notes with satisfaction* the completion of the draft Convention on the Carriage of Goods by Sea[4] and the adoption by the Commission of the Arbitration Rules of the United Nations Commission on International Trade Law;[5]

4. *Further notes with satisfaction* that a draft convention on the international sale of goods has been prepared by a working group of the United Nations Commission on International Trade Law and that this draft convention has been transmitted to Governments and interested international organizations for their comments;

5. *Welcomes* the decision of the United Nations Commission on International Trade Law to hold a second international symposium on international trade law in connexion with its tenth session in 1977 and, in view of the fact that the symposium is financed by voluntary contributions, appeals to Governments to contribute to the costs of the symposium;

6. *Recommends* that the United Nations Commission on International Trade Law should:

(*a*) Continue its work on the topics included in its programme of work;

(*b*) Continue its work on training and assistance in the field of international trade law, taking into account the special interests of the developing countries;

(*c*) Maintain close collaboration with the United Nations Conference on Trade and Development and continue to collaborate with international organizations active in the field of international trade law;

(*d*) Maintain liaison with the Commission on Transnational Corporations with regard to the consideration of legal problems that would be susceptible of action by it;

(*e*) Continue to give special consideration to the interests of developing countries and to bear in mind the special problems of land-locked countries;

(*f*) Keep its programme of work and working methods under review with the aim of further increasing the effectiveness of its work;

7. *Calls upon* the United Nations Commission on International Trade Law to continue to take account of the relevant provisions of the resolutions of the sixth and seventh special sessions of the General Assembly that laid down the foundations of the new international economic order, bearing in mind the need for United

[2] *Ibid., Supplement No. 17* (A/31/17). Yearbook . . . 1976, part one, II, A.

[3] *Ibid., Supplement No. 15* (A/31/15), vol. II, para. 268. (See above, part one, I, A.)

[4] *Ibid., Supplement No. 17* (A/31/17), chap. IV, sect. C. (Yearbook . . . 1976, part one, II, A)

[5] *Ibid.*, chap. V, sect. C.

Nations organs to participate in the implementation of those resolutions;

8. *Invites* the Commission on Transnational Corporations, if it identifies specific legal issues in its programme of work that would be susceptible of action by the United Nations Commission on International Trade Law, to refer such issues to that Commission for its consideration;

9. *Welcomes* the decision of the United Nations Commission on International Trade Law to review, in the near future, its long-term programme and, in this connexion, requests the Secretary-General to invite Governments to submit their views and suggestions on such a programme;

10. *Decides* that:

(*a*) The term of office of those members of the United Nations Commission on International Trade Law whose term would expire on 31 December 1976 is extended until the last day prior to the beginning of the regular annual session of the Commission in 1977 and the term of office of those members of the Commission whose term would expire on 31 December 1979 is extended until the last day prior to the beginning of the regular annual session of the Commission in 1980;

(*b*) Commencing with the elections to membership of the United Nations Commission on International Trade Law at the thirty-first session of the General Assembly, all States elected to membership shall take office at the beginning of the first day of the regular annual session of the Commission immediately following their election and their terms of office shall expire on the last day prior to the opening of the seventh regular annual session of the Commission following their election;

(*c*) Governments of Member States that are not members of the United Nations Commission on International Trade Law are entitled, when they so request, to attend the sessions of the Commission and its Working Groups as observers;

11. *Requests* the Secretary-General to forward to the United Nations Commission on International Trade Law the records of the discussions at the thirty-first session of the General Assembly on the Commission's report on the work of its ninth session.

99th plenary meeting

31/100. United Nations Conference on the Carriage of Goods by Sea

The General Assembly,

Recalling its resolution 2205 (XXI) of 17 December 1966, by which it established the United Nations Commission on International Trade Law and defined the object and terms of reference of the Commission,

Having considered chapter IV of the report of the United Nations Commission on International Trade Law on the work of its ninth session[6] which contains draft articles for a convention on the carriage of goods by sea,

Noting that the United Nations Commission on International Trade Law considered and adopted the draft articles taking note of observations and comments submitted by Governments, by the Working Group on International Shipping Legislation of the United Nations Conference on Trade and Development and by international organizations,

Taking note with appreciation of the comments of the Trade and Development Board of the United Nations Conference on Trade and Development that the revision of the law on carriage of goods by sea involves consideration not only of legal but also of economic and shipping trade aspects, and that these aspects should be given due consideration at an international conference of plenipotentiaries,[7]

Convinced that international trade is an important factor in the promotion of friendly relations among States and that the adoption of a convention on the carriage of goods by sea which would take into account the legitimate interests of all States, particularly those of the developing countries, which would remove such uncertainties and ambiguities as exist in the rules and practices relating to bills of lading and which would establish a balanced allocation of risks between the cargo owner and the carrier, would contribute to the harmonious development of international trade,

1. *Expresses its appreciation* to the United Nations Commission on International Trade Law for the valuable work done in having prepared draft articles for a convention on the carriage of goods by sea;

2. *Decides* that an international conference of plenipotentiaries shall be convened in 1978 in New York, or at any other suitable place for which the Secretary-General may receive an invitation, to consider the question of the carriage of goods by sea and to embody the results of its work in an international convention and such other instruments as it may deem appropriate;

3. *Refers* to the conference the draft articles for a convention on the carriage of goods by sea approved by the United Nations Commission on International Trade Law, together with draft provisions concerning implementation, reservations and other final clauses to be prepared by the Secretary-General;

4. *Requests* the Secretary-General:

(*a*) To circulate the draft Convention on the Carriage of Goods by Sea,[8] together with draft provisions concerning implementation, reservations and other final clauses to be prepared by the Secretary-General, to Governments and interested international organizations for comments and proposals;

(*b*) To convene the United Nations Conference on the Carriage of Goods by Sea for an appropriate period in 1978 at any of the places referred to in paragraph 2 above;

(*c*) To arrange for the preparation of summary records of the proceedings of the plenary meetings of the Conference and of meetings of committees of the whole which the Conference may wish to establish;

(*d*) To invite all States to participate in the United Nations Conference on the Carriage of Goods by Sea;

[6] *Ibid., Supplement No. 17* (A/31/17).

[7] TD/B/C.4/153, annex I.

[8] *Official Records of the General Assembly, Thirty-first Session, Supplement No. 17* (A/31/17), chap. IV, sect. C. (Yearbook ... 1976, part one, II, A)

(*e*) To invite representatives of organizations that have received a standing invitation from the General Assembly to participate in the sessions and the work of all international conferences convened under its auspices, in the capacity of observers, in accordance with Assembly resolution 3237 (XXIX) of 22 November 1974;

(*f*) To invite representatives of the national liberation movements recognized in its region by the Organization of African Unity, in the capacity of observers, in accordance with General Assembly resolution 3280 (XXIX) of 10 December 1974;

(*g*) To invite the specialized agencies and the International Atomic Energy Agency, as well as interested organs of the United Nations and interested regional intergovernmental organizations, to be represented at the Conference by observers;

(*h*) To draw the attention of the States and other participants referred to in subparagraphs (*d*) to (*g*) above to the desirability of appointing as their representatives persons especially competent in the field to be considered;

(*i*) To place before the Conference:

(i) All comments and proposals received from Governments;

(ii) Working and background papers which may be received from the United Nations Commission on International Trade Law, the United Nations Conference on Trade and Development and other interested international organizations, taking into consideration the legal, economic and shipping trade aspects of the draft Convention;

(iii) Draft provisions concerning implementation, reservations and other final clauses and all relevant documentation and recommendations relating to methods of work and procedure;

(*j*) To ensure that all relevant documentation for the Conference will be distributed to all participants in the Conference at the earliest possible date;

(*k*) To arrange for adequate staff and facilities required for the Conference, bearing in mind the fact that the legal, economic and shipping trade aspects of the carriage of goods by sea should receive due consideration at the Conference.

99th plenary meeting

II. THE TENTH SESSION (1977)

A. Report of the United Nations Commission on International Trade Law on the work of its tenth session (Vienna, 23 May–17 June 1977) (A/32/17)*

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INTRODUCTION

1. The present report of the United Nations Commission on International Trade Law covers the Commission's tenth session, held at Vienna from 23 May to 17 June 1977.

2. Pursuant to General Assembly resolution 2205 (XXI) of 17 December 1966, this report is submitted to the General Assembly and is also submitted for comments to the United Nations Conference on Trade and Development.

CHAPTER I. ORGANIZATION OF THE SESSION

A. *Opening*

3. The United Nations Commission on International Trade Law (UNCITRAL) commenced its tenth session on 23 May 1977. The session was opened on behalf of the Secretary-General by Mr. Erik Suy, the Legal Counsel.

B. *Membership and attendance*

4. General Assembly resolution 2205 (XXI) established the Commission with a membership of 29 States, elected by the Assembly. By resolution 3108 (XXVIII), the General Assembly increased the membership of the Commission from 29 to 36 States. The present members of the Commission, elected on 12 December 1973 and 15 December 1976, are the following States:[1] Argentina,* Australia,** Austria,** Barbados,* Belgium,* Brazil,* Bulgaria,* Burundi,** Chile,** Colombia,** Cyprus,* Czechoslovakia,* Egypt,** Finland,** France,** Gabon,* German Democratic Republic,** Germany, Federal Republic of,* Ghana,** Greece,* Hungary,* India,* Indonesia,** Japan,** Kenya,* Mexico,* Nigeria,** Philippines,* Sierra Leone,* Singapore,** Syrian Arab Republic,* Union of Soviet Socialist Republics,** United Kingdom of Great Britain and Northern Ireland,** United Republic of Tanzania,** United States of America* and Zaire.*

* *Official Records of the General Assembly, Thirty-second Session, Supplement No. 17.*

* Term of office expires on the day before the opening of the regular annual session of the Commission in 1980.

** Term of office expires on the day before the opening of the regular annual session of the Commission in 1983.

[1] Pursuant to General Assembly resolution 2205 (XXI), the

5. With the exception of Burundi, Cyprus, Gabon, Kenya, Sierra Leone, the Syrian Arab Republic and the United Republic of Tanzania, all members of the Commission were represented at the session.

6. The session was also attended by observers from the following States Members of the United Nations: Costa Rica, Cuba, Denmark, Ireland, Malaysia, Mauritania, Mauritius, Norway, Poland, Romania, Spain, Sweden, Turkey, Uruguay and Yugoslavia; and from the following non-member States of the United Nations: Holy See and Switzerland.

7. The following United Nations organs, specialized agencies, intergovernmental organizations and international non-governmental organizations were represented by observers:

(a) *United Nations organs*

United Nations Industrial Development Organization.

(b) *Specialized agencies*

Inter-Governmental Maritime Consultative Organization; International Monetary Fund (IMF).

(c) *Intergovernmental organizations*

Asian-African Legal Consultative Committee; Bank for International Settlements; Caribbean Community; Commission of the European Communities; Council for Mutual Economic Assistance; Council of Europe; East African Community; Hague Conference on Private International Law; International Institute for the Unification of Private Law.

(d) *International non-governmental organizations*

International African Law Association; International Chamber of Commerce; International Law Association.

C. *Election of officers*

8. The Commission elected the following officers by acclamation:[2]

Chairman .....Mr. N. Gueiros (Brazil)
Vice-Chairman ....Mr. O. Adeniji (Nigeria)
Vice-Chairman ....Mr. M. Byers (Australia)
Vice-Chairman ....Mr. S. Michida (Japan)
Rapporteur .....Mr. L. Kopač (Czechoslovakia)

D. *Agenda*

9. The agenda of the session as adopted by the Commission at its 182nd meeting, on 25 May 1977, was as follows:

1. Opening of the session
2. Election of officers
3. Adoption of the agenda; tentative schedule of meetings
4. International sale of goods
5. International payments
6. International commercial arbitration
7. Liability for damage caused by products intended for or involved in international trade
8. Training and assistance in the field of international trade law
9. Future work
10. Other business
11. Date and place of the eleventh session
12. Adoption of the report of the Commission

E. *Establishment of two Committees of the Whole*

10. The Committee established two Committees of the Whole (Committee I and Committee II) and referred to them for consideration the following agenda items:

Committee I

Item 4. International sale of goods: draft Convention on the International Sale of Goods.

Committee II

Item 4. International sale of goods: general conditions of sale.

Item 5. International payments:
(*a*) Security interests in goods
(*b*) Negotiable instruments.

Item 6. International commercial arbitration.

Item 7. Liability for damage caused by products intended for or involved in international trade.

Item 8. Training and assistance in the field of international trade law.

Item 10. Other business: consistency of legal provisions drafted by the Commission or its Working Groups.

11. Committee I met from 23 May to 17 June 1977 and held 32 meetings.[3] Committee II met on 6, 7 and 9 June 1977 and held 5 meetings.[4]

members of the Commission are elected for a term of six years, except that, in connexion with the initial election, the terms of 14 members, selected by the President of the Assembly, by drawing lots, expired at the end of three years (31 December 1970); the terms of the 15 other members expired at the end of six years (31 December 1973). Accordingly, the General Assembly, at its twenty-fifth session elected 14 members to serve for a full term of six years, ending on 31 December 1976, and, at its twenty-eighth session, elected 15 members to serve for a full term of six years, ending on 31 December 1979. The General Assembly, at its twenty-eighth session, also selected seven additional members. Of these additional members, the term of three members, selected by the President of the Assembly by drawing lots, would expire at the end of three years (31 December 1976) and the term of four members would expire at the end of six years (31 December 1979). To fill the vacancies on the Commission which would occur on 31 December 1976, the General Assembly, at its thirty-first session, on 15 December 1976, elected (or re-elected) 17 members to the Commission. Pursuant to resolution 31/99 of 15 December 1976, the new members took office on the first day of the regular annual session of the Commission immediately following their election (23 May 1977) and their term will expire on the last day prior to the opening of the seventh regular annual session of the Commission following their election (in 1983). In addition, the term of office of those members whose term would expire on 31 December 1979 was by the same resolution extended till the last day prior to the beginning of the regular annual session of the Commission in 1980.

[2] The election took place at the 180th and 181st meetings, on 23 May 1977, and at the 182nd meeting, on 25 May 1977. In accordance with a decision taken by the Commission at its first session, the Commission has three Vice-Chairmen, so that, together with the Chairman and Rapporteur, each of the five groups of States listed in General Assembly resolution 2205 (XXI), sect. II, para. 1, will be represented on the bureau of the Commission (see *Official Records of the General Assembly, Twenty-third Session, Supplement No. 16* (A/7216), para. 14 (Yearbook ... 1968-1970, part two, I)).

[3] Summary records of the meetings of Committee I are contained in A/CN.9(X)/C.1/SR.1 to 32.

[4] Summary records of the meetings of Committee II are contained in A/CN.9(X)/C.2/SR.1 to 5.

12. The Commission, at its 180th meeting, on 23 May 1977, unanimously elected Mr. G. Eörsi (Hungary) as Chairman of Committee I. At its 4th meeting, on 25 May 1977, Committee I unanimously elected Mr. J. Barrera-Graf (Mexico) as Rapporteur. At its 1st meeting, on 6 June 1977, Committee II unanimously elected Mr. R. Loewe (Austria) as Chairman and Mr. C. O. Magreola (Nigeria) as Rapporteur.

13. The Commission considered the reports of Committee I and Committee II at its 185th and 186th meetings on 17 June 1977. The Commission decided to include the reports of Committees I and II in the present report in the form of annexes (annex I and annex II, respectively).

F. *Adoption of the report*

14. The Commission adopted the present report at its 185th and 186th meetings, on 17 June 1977.

CHAPTER II. INTERNATIONAL SALE OF GOODS

A. *Uniform rules governing the international sale of goods*

Introduction

15. The Commission, at its second session, established a Working Group on the International Sale of Goods and requested it to ascertain which modifications of the text of the Uniform Law on the International Sale of Goods (ULIS), annexed to the 1964 Hague Convention, might render that Convention capable of wider acceptance or whether it would be necessary to elaborate a new text for this purpose.[5] The Working Group held seven sessions in carrying out its mandate in respect of the revision of ULIS and submitted to the ninth session of the Commission the text of a draft Convention on the International Sale of Goods.[6] At that session, the Commission decided to consider the draft Convention at its tenth session, in the light of the comments received from Governments and interested international organizations.

16. At the present session the Commission had before it the following documents:

(*a*) Report of the Working Group on the International Sale of Goods on the work of its seventh session (A/CN.9/116).* This document reproduces, in annex I, the text of the draft Convention as approved by the Working Group, and in annex II, a commentary on the draft Convention.

(*b*) Comments by Governments and international organizations on the draft Convention on the International Sale of Goods (A/CN.9/125 and Add. 1, 2 and 3).*

(*c*) Analysis of the comments by Governments and international organizations on the draft Convention on the International Sale of Goods (A/CN.9/126).*

(*d*) Draft Convention on the International Sale of Goods: draft final clauses (A/CN.9/135).*

(*e*) Possible Conference of Plenipotentiaries to conclude a Convention on the International Sale of Goods: financial implications (A/CN.9/140).

17. The Commission established a Committee of the Whole I to consider the draft Convention on the International Sale of Goods as adopted by the Working Group on the International Sale of Goods, and requested the Committee to report back to it. Committee I met from 23 May to 17 June 1977 and held 32 meetings. The report of Committee I to the Commission is set forth in annex I to the present report.

Report of Committee of the Whole I[7]

18. The Commission accepted the report of Committee I and the recommendations contained therein. The Commission noted that the Committee had not had sufficient time to consider the draft texts proposed by the Drafting Group.[8] It was noted that the Committee had considered in detail each individual article of the draft Convention, that the Drafting Group established by the Committee had based its work on the decisions taken and conclusions reached in the Committee, and that the Committee had adopted the texts of the articles of the draft Convention as revised by the Drafting Group without further consideration.

19. The Commission also noted that the report of Committee I sets forth reservations made by representatives in respect of certain provisions of the draft Convention and was of the view that, because of the fact that these reservations were made in a Committee of the Whole of the Commission, they should be considered as having been made in the Commission.

B. *Conference of plenipotentiaries*[9]

20. The Commission considered in the context of future action relative to the draft Convention on the International Sale of Goods a proposal that consideration be given to issuing the set of rules on the international sale of goods, elaborated by the Commission, in the form not of a convention as had been planned, but as uniform rules for optional use by the parties to a sales transaction.

21. In support of this proposal, it was argued, firstly, that the suggested procedure would result in substantial cost savings to the United Nations and to States which, in view of the current financial situation of the Organization and of many States, was not an insignificant con-

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[5] *Official Records of the General Assembly, Twenty-fourth Session, Supplement No. 18* (A/7618), para. 38, subpara. 3 (a) of the resolution contained therein (*Yearbook of the United Nations Commission on International Trade Law, Volume I:* 1968-1970) (United Nations publication, Sales No. E.71.V.1), part two, chap. II, para. 38, subpara. 3 (a). The 1964 Hague Convention relating to a Uniform Law on the International Sale of Goods and the annexed Uniform Law (ULIS) appears in the *Register of Texts of Conventions and Other Instruments Concerning International Trade Law*, vol. 1 (United Nations publication, Sales No. E.71.V.3), chap. I, sect. I.

[6] Report of the Working Group on the International Sale of Goods on the work of its seventh session (Geneva, 5-16 January 1976), A/CN.9/116.* The text of the draft Convention is set out in annex I of the report.

* Yearbook . . .1976, part two, I.

* Reproduced in this volume, part two, I, F.

[7] This report was before the Commission at its 185th and 186th meetings; summary records of these meetings are contained in A/CN.9/SR.185 and 186.

[8] See para. 7 of the report of the Committee of the Whole I (annex I to this report).

[9] The Commission considered this subject at its 183rd meeting, on 15 June 1977; a summary record of this meeting is contained in A/CN.9/SR.183.

sideration. In comparison to the considerable costs of holding a conference of plenipotentiaries such as was planned, the cost of issuing (i.e., printing and publishing) uniform rules were almost negligible, as had been demonstrated in the case of the UNCITRAL Arbitration Rules which had been issued in the form now being proposed for the rules on sales. Secondly, it was argued that the form of uniform rules such as was being proposed had the advantage over that of a convention in that it provided more flexibility and greater opportunity to change the rules, if need be, than would be the case for a convention. This, it was emphasized, was a significant consideration in the context of rules designed to regulate business practices which themselves were constantly changing.

22. Thirdly, and most significantly, the form of optional rules should be favoured because it would in fact lead to a more speedy implementation of the régime contemplated than would resort to the traditional method of concluding a convention. Uniform rules could be quickly promulgated and thereafter put into immediate use, as had happened in the case of the UNCITRAL Arbitration Rules which, within only a few months of their issue, had already been adopted by the business community in many parts of the world. On the other hand, it was well known how cumbersome and lengthy a procedure must be undergone between the drafting of a text of a convention and the coming into effect of that convention.

23. For all these reasons, it was suggested, the Commission should not at this stage take a final decision on the form in which the rules would be promulgated; it would be advisable first to seek the views of States and of both the Fifth and Sixth Committees of the General Assembly.

24. Some representatives, while not formally supporting the proposal to issue the rules on sales in the form of optional uniform rules, stated that they shared some of the concerns underlying the proposal. The traditional technique of legislating on the international level by the use of conventions was too cumbersome and ill-suited to the task of unification in the sphere of private law. What was required, it was said, was a new approach, better adapted to the needs of regulating private conduct and the Commission should give serious consideration to this question with a view to devising such a method for its future work.

25. Most representatives who spoke on the matter were against the proposal to issue the rules on sales in the form of optional rules and not as a convention. It was generally pointed out that work on the text had proceeded throughout on the basis that the Working Group was engaged in the elaboration of the draft of a future convention and now that that work had been completed and an agreed text presented to the Commission for consideration it was hardly the time to seek to reopen the question of the form in which the rules should be promulgated.

26. Among other reasons adduced against the proposal were the following. To adopt the form of optional uniform rules, thereby dispensing with the need for a conference of plenipotentiaries to consider the text, would deprive many States, especially developing States and those States not represented on the Commission, of the opportunity to scrutinize the draft text in connexion with such a conference and to influence at the conference the final content and form of that text. Furthermore, it was observed, developing countries had frequently voiced dissatisfaction with international trade practices in the evolution of which they had played no determining role. They would, therefore, prefer to see these trade practices revised by means, wherever possible, of binding multilateral treaties.

27. Furthermore, to promulgate the rules on sales in a form less binding than a convention would not foster the objective of harmonization and unification of international trade law which the Commission was committed to serve since, unlike a convention which applies where the parties have not exercised the right, if granted them, to derogate from its provisions, optional rules were subject to the individual wishes of businessmen. Moreover, optional rules were always open to abuse by the stronger trading party who could very quickly modify the rules to their own advantage and obtain acceptance of such terms by the weaker party in the manner of "contracts of adhesion".

28. With regard to the cost argument, it was noted that the Commission and its Working Group and also those Governments which had been represented at the Working Group's sessions had already invested well over seven years of work and expense in elaborating the draft Convention in question, all or some of which investment might have been unnecessary if the known objective were to produce uniform rules of an optional character. Similarly, with regard to the argument of relative speed of implementation, it was pointed out that nothing would preclude parties after approval of a text by the Conference of Plenipotentiaries from incorporating provisions therefrom into their sales contracts regardless of the question of ratification by States.

29. A number of representatives, speaking in favour of the form of a convention, observed that it would be anomalous for the Commission to issue the rules regulating the actual sales transaction in the form of optional rules when it had utilized the convention technique with regard to the secondary matter of limitation of action. Furthermore, the related matters of formation and validity of sales contracts, on which work was in progress within the Commission, did not lend themselves to the form of optional rules and would, therefore, have to be promulgated in the form of a convention, leading to even greater anomaly should the rules on sales be issued in the form now proposed to the Commission.

30. Some representatives also drew attention to the fact that for many legal systems the preferred manner for receiving international legal rules into national law was by means of treaties and conventions. For such States the promulgation of the rules on sales in the form of merely optional rules for parties would present certain difficulties of implementation.

31. Two ideas were put forward as to possible alternatives that would meet some of the concerns expressed on both sides of this issue. The first was for the rules on sales to be promulgated both as uniform rules for optional use by parties and as a convention. One advantage of this would be that the rules could be in use long before the convention had gone into effect. The other idea would have the Commission obtain by written communication the views and comments of Governments on its draft text and, taking those views and

comments into consideration, adopt itself a final text of a treaty, thereby avoiding the high cost of holding a conference of plenipotentiaries.

32. The Commission decided, in view of the position taken by most representatives, not to adopt the proposal to issue as uniform rules for optional adoption by parties the rules on the international sale of goods, but to recommend to the General Assembly that they should be adopted in the form of a convention.

Formation and validity of contracts for the international sale of goods[10]

33. The Commission decided that, if the Working Group on the International Sale of Goods should, at its ninth session in September 1977, finalize draft provisions on the formation and validity of contracts for the international sale of goods, it would consider these draft provisions at its eleventh session in June 1978. The Commission also decided that, in conjunction with its consideration of these draft provisions, it would consider the question whether the rules on formation and validity of contracts should be the subject-matter of a convention separate from the Convention on the International Sale of Goods and, if so, whether the two conventions should be submitted to one and the same conference of plenipotentiaries or to two separate conferences.

Decision of the Commission

34. At its 186th meeting, on 17 June 1977, the Commission adopted the following decision:

The United Nations Commission on International Trade Law

1. *Approves* the text of the draft Convention on the International Sale of Goods, as set out below in paragraph 35 of the report of the Commission;

2. *Requests* the Secretary-General:

(*a*) To prepare, under his own authority, a commentary on the provisions of the draft Convention.

(*b*) To circulate the draft Convention, together with the commentary thereon, to Governments and to interested international organizations for comments and proposals;

(*c*) To prepare an analytical compilation of the comments and proposals received from Governments and interested international organizations and to submit this analytical compilation to a Conference of Plenipotentiaries which the General Assembly may wish to convene;

3. *Recommends* that the General Assembly should, at an appropriate time, convene an international Conference of Plenipotentiaries to conclude, on the basis of the draft Convention approved by the Commission, a Convention on the International Sale of Goods;

4. *Informs* the General Assembly that the Commission may place before it, at its thirty-third session, draft provisions on the Formation and Validity of Contracts for the International Sale of Goods together with appropriate recommendations on the action to be taken in respect of those draft provisions, including the question whether such draft provisions should be considered at the Conference referred to in paragraph 3 of the present decision.

[10] The Commission considered this subject at its 186th meeting on 17 June 1977; a summary record of this meeting is contained in A/CN.9/SR.186.

C. *Text of the draft Convention on the International Sale of Goods*

35. The draft Convention on the International Sale of Goods, as approved by the Commission, reads as follows:

DRAFT CONVENTION ON THE INTERNATIONAL SALE OF GOODS

Part I. Substantive Provisions

CHAPTER I. SPHERE OF APPLICATION

Article 1

(1) This Convention applies to contracts of sale of goods entered into by parties whose places of business are in different States:

(*a*) When the States are Contracting States; or

(*b*) When the rules of private international law lead to the application of the law of a Contracting State.

(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.

(3) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration.

Article 2

This Convention does not apply to sales:

(*a*) Of goods bought for personal, family or household use, unless the seller, at the time of the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use;

(*b*) By auction;

(*c*) On execution or otherwise by authority of law;

(*d*) Of stocks, shares, investment securities, negotiable instruments or money;

(*e*) Of ships, vessels or aircraft;

(*f*) Of electricity.

Article 3

(1) This Convention does not apply to contracts in which the preponderant part of the obligations of the seller consists in the supply of labour or other services.

(2) Contracts for the supply of goods to be manufactured or produced are to be considered sales unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production.

Article 4

The parties may exclude the application of this Convention or derogate from or vary the effect of any of its provisions.

Article 5

For the purposes of this Convention:

(*a*) If a party has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at the time of the conclusion of the contract;

(*b*) If a party does not have a place of business, reference is to be made to his habitual residence.

Article 6

This Convention governs only the rights and obligations of the seller and the buyer arising from a contract of sale. In particular, except as otherwise expressly provided therein, this Convention is not concerned with:

(*a*) The formation of the contract;

(*b*) The validity of the contract or of any of its provisions or of any usage;

(*c*) The effect which the contract may have on the property in the goods sold.

CHAPTER II. GENERAL PROVISIONS

Article 7

(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.

(2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.

Article 8

A breach committed by one of the parties is fundamental if it results in substantial detriment to the other party unless the party in breach did not foresee and had no reason to foresee such a result.

Article 9

A declaration of avoidance of the contract is effective only if made by notice to the other party.

Article 10

Unless otherwise expressly provided in this Convention, if any notice, request or other communication is given by a party in accordance with this Convention and by means appropriate in the circumstances, a delay or error in the transmission of the communication or its failure to arrive does not deprive that party of the right to rely on the communication.

Article 11

(1) A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirements as to form. It may be proved by any means including witnesses.

(2) Paragraph (1) of this article does not apply to a contract of sale where any party has his place of business in a Contracting State which has made a declaration under article (X) of this Convention.*

Article 12

If, in accordance with the provisions of this Convention, one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgement for specific performance unless the court could do so under its own law in respect of similar contracts of sale not governed by this Convention.

Article 13

In the interpretation and application of the provisions of this Convention, regard is to be had to its international character and to the need to promote uniformity.

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* *Article (X)*

A Contracting State whose legislation requires a contract of sale to be concluded in or evidenced by writing may, at the time of signature, ratification or accession, make a declaration to the effect that article 11, paragraph (1), shall not apply to any sale involving a party having his place of business in a State which has made such a declaration.

CHAPTER III. OBLIGATIONS OF THE SELLER

Article 14

The seller must deliver the goods, hand over any documents relating thereto and transfer the property in the goods, as required by the contract and this Convention.

Section I. Delivery of the goods and handing over of documents

Article 15

If the seller is not bound to deliver the goods at any other particular place, his obligation to deliver consists:

(*a*) If the contract of sale involves carriage of the goods — in handing the goods over to the first carrier for transmission to the buyer;

(*b*) If, in cases not within the preceding subparagraph, the contract relates to specific goods, or unidentified goods to be drawn from a specific stock or to be manufactured or produced, and at the time of the conclusion of the contract the parties knew that the goods were at, or were to be manufactured or produced at, a particular place—in placing the goods at the buyer's disposal at that place;

(*c*) In other cases — in placing the goods at the buyer's disposal at the place where the seller had his place of business at the time of the conclusion of the contract.

Article 16

(1) If the seller is bound to hand the goods over to a carrier and if the goods are not clearly marked with an address or are not otherwise identified to the contract, the seller must send the buyer a notice of the consignment which specifies the goods.

(2) If the seller is bound to arrange for carriage of the goods, he must make such contracts as are necessary for the carriage to the place fixed by means of transportation which are appropriate in the circumstances and according to the usual terms for such transportation.

(3) If the seller is not bound to effect insurance in respect of the carriage of the goods, he must provide the buyer, at his request, with all available information necessary to enable him to effect such insurance.

Article 17

The seller must deliver the goods:

(*a*) If a date is fixed by or determinable from the contract, on that date; or

(*b*) If a period of time is fixed by or determinable from the contract, at any time within that period unless circumstances indicate that the buyer is to choose a date; or

(*c*) In any other case, within a reasonable time after the conclusion of the contract.

Article 18

If the seller is bound to hand over documents relating to the goods, he must hand them over at the time and place and in the form required by the contract.

Section II. Conformity of the goods and third party claims

Article 19

(1) The seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract. Except where otherwise agreed, the goods do not conform with the contract unless they:

(*a*) Are fit for the purposes for which goods of the same description would ordinarily be used;

(*b*) Are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the

contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgement;

(*c*) Possess the qualities of goods which the seller has held out to the buyer as a sample or model;

(*d*) Are contained or packaged in the manner usual for such goods.

(2) The seller is not liable under subparagraphs (*a*) to (*d*) of paragraph (1) of this article for any non-conformity of the goods if at the time of the conclusion of the contract the buyer knew or could not have been unaware of such non-conformity.

Article 20

(1) The seller is liable in accordance with the contract and this Convention for any lack of conformity which exists at the time when the risk passes to the buyer, even though the lack of conformity becomes apparent only after that time.

(2) The seller is also liable for any lack of conformity which occurs after the time indicated in paragraph (1) of this article and which is due to a breach of any of his obligations, including a breach of any express guarantee that the goods will remain fit for their ordinary purpose or for some particular purpose, or that they will retain specified qualities or characteristics for a specific period.

Article 21

If the seller has delivered goods before the date for delivery, he may, up to that date, deliver any missing part or make up any deficiency in the quantity of the goods delivered, or deliver goods in replacement of any non-conforming goods delivered or remedy any lack of conformity in the goods delivered, provided that the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense. The buyer retains any right to claim damages as provided for in this Convention.

Article 22

(1) The buyer must examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances.

(2) If the contract involves carriage of the goods, examination may be deferred until after the goods have arrived at their destination.

(3) If the goods are redispatched by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redispatch, examination may be deferred until after the goods have arrived at the new destination.

Article 23

(1) The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.

(2) In any event, the buyer loses the right to rely on a lack of conformity of the goods if he does not give the seller notice thereof at the latest within a period of two years from the date on which the goods were actually handed over to the buyer, unless such time-limit is inconsistent with a contractual period of guarantee.

Article 24

The seller is not entitled to rely on the provisions of articles 22 and 23 if the lack of conformity relates to facts of which he knew or could not have been unaware and which he did not disclose to the buyer.

Article 25

(1) The seller must deliver goods which are free from any right or claim of a third party, other than one based on industrial or intellectual property, unless the buyer agreed to take the goods subject to that right or claim.

(2) The buyer does not have the right to rely on the provisions of this article if he does not give notice to the seller specifying the nature of the right or claim of the third party within a reasonable time after he became aware or ought to have become aware of the right of claim.

Article 26

(1) The seller must deliver goods which are free from any right or claim of a third party based on industrial or intellectual property, of which at the time of the conclusion of the contract the seller knew or could not have been unaware, provided that that right or claim is based on industrial or intellectual property.

(*a*) Under the law of the State where the goods will be resold or otherwise used if it was contemplated by the parties at the time of the conclusion of the contract that the goods would be resold or otherwise used in that State; or

(*b*) In any other case under the law of the State where the buyer has his place of business.

(2) The obligation of the seller under paragraph (1) of this article does not extend to cases where:

(*a*) At the time of the conclusion of the contract the buyer knew or could not have been unaware of the right or claim; or

(*b*) The right or claim results from the seller's compliance with technical drawings, designs, formulae or other such specifications furnished by the buyer.

(3) The buyer does not have the right to rely on the provisions of this article if he does not give notice to the seller specifying the nature of the right or claim of the third party within a reasonable time after he became aware or ought to have become aware of the right or claim.

Section III. Remedies for breach of contract by the seller

Article 27

(1) If the seller fails to perform any of his obligations under the contract and this Convention, the buyer may:

(*a*) Exercise the rights provided in articles 28 to 34;

(*b*) Claim damages as provided in articles 56 to 59.

(2) The buyer is not deprived of any right he may have to claim damages by exercising his right to other remedies.

(3) No period of grace may be granted to the seller by a court or arbitral tribunal when the buyer resorts to a remedy for breach of contract.

Article 28

(1) The buyer may require performance by the seller of his obligations unless the buyer has resorted to a remedy which is inconsistent with such requirement.

(2) If the goods do not conform with the contract, the buyer may require delivery of substitute goods only if the lack of conformity constitutes a fundamental breach and a request for substitute goods is made either in conjunction with notice given under article 23 or within a reasonable time thereafter.

Article 29

(1) The buyer may fix an additional period of time of reasonable length for performance by the seller of his obligations.

(2) Unless the buyer has received notice from the seller that he will not perform within the period so fixed, the buyer may not, during that period, resort to any remedy for breach of contract. However, the buyer is not deprived thereby of any right he may have to claim damages for delay in the performance.

Article 30

(1) Unless the buyer has declared the contract avoided in accordance with article 31, the seller may, even after the date for delivery, remedy at his own expense any failure to perform

his obligations, if he can do so without such delay as will amount to a fundamental breach of contract and without causing the buyer unreasonable inconvenience or uncertainty of reimbursement by the seller of expenses advanced by the buyer. The buyer retains any right to claim damages as provided for in this Convention.

(2) If the seller requests the buyer to make known whether he will accept performance and the buyer does not comply with the request within a reasonable time, the seller may perform within the time indicated in his request. The buyer may not, during that period of time, resort to any remedy which is inconsistent with performance by the seller.

(3) A notice by the seller that he will perform within a specified period of time is assumed to include a request, under paragraph (2) of this article, that the buyer make known his decision.

(4) A request or notice by the seller under paragraphs (2) and (3) of this article is not effective unless received by the buyer.

Article 31

(1) The buyer may declare the contract avoided:

(*a*) If the failure by the seller to perform any of his obligations under the contract and this Convention amounts to a fundamental breach of contract; or

(*b*) If the seller has not delivered the goods within the additional period of time fixed by the buyer in accordance with paragraph (1) of article 29 or has declared that he will not deliver within the period so fixed.

(2) However, in cases where the seller has made delivery, the buyer loses his right to declare the contract avoided unless he has done so within a reasonable time:

(*a*) In respect of late delivery, after he has become aware that delivery has been made; or

(*b*) In respect of any breach other than late delivery, after he knew or ought to have known of such breach, or after the expiration of any additional period of time fixed by the buyer in accordance with paragraph (1) of article 29, or after the seller has declared that he will not perform his obligations within such an additional period.

Article 32

If the goods do not conform with the contract and whether or not the price has already been paid, the buyer may declare the price to be reduced in the same proportion as the value that the goods actually delivered would have had at the time of the conclusion of the contract bears to the value that conforming goods would have had at that time. However, if the seller remedies any failure to perform his obligations in accordance with article 30 or if he is not allowed by the buyer to remedy that failure in accordance with that article, the buyer's declaration of reduction of the price is of no effect.

Article 33

(1) If the seller delivers only a part of the goods or if only a part of the goods delivered is in conformity with the contract, the provisions of articles 28 to 32 apply in respect of the part which is missing or which does not conform.

(2) The buyer may declare the contract avoided in its entirety only if the failure to make delivery completely or in conformity with the contract amounts to a fundamental breach of the contract.

Article 34

(1) If the seller delivers the goods before the date fixed, the buyer may take delivery or refuse to take delivery.

(2) If the seller delivers a quantity of goods greater than that provided for in the contract, the buyer may take delivery or refuse to take delivery of the excess quantity. If the buyer takes delivery of all or part of the excess quantity, he must pay for it at the contract rate.

CHAPTER IV. OBLIGATIONS OF THE BUYER

Article 35

The buyer must pay the price for the goods and take delivery of them as required by the contract and this Convention.

Section I. Payment of the price

Article 36

The buyer's obligation to pay the price includes taking such steps and complying with such formalities as may be required under the contract or any relevant laws and regulations to enable payment to be made.

*Article 37**

If a contract has been validly concluded but does not state the price or expressly or impliedly make provision for the determination of the price of the goods, the buyer must pay the price generally charged by the seller at the time of the conclusion of the contract. If no such price is ascertainable, the buyer must pay the price generally prevailing at the aforesaid time for such goods sold under comparable circumstances.

Article 38

If the price is fixed according to the weight of the goods, in case of doubt it is to be determined by the net weight.

Article 39

(1) If the buyer is not bound to pay the price at any other particular place, he must pay it to the seller:

(*a*) At the seller's place of business; or

(*b*) If the payment is to be made against the handing over of the goods or of documents, at the place where the handing over takes place.

(2) The seller must bear any increase in the expenses incidental to payment which is caused by a change in the place of business of the seller subsequent to the conclusion of the contract.

Article 40

(1) The buyer must pay the price when the seller places either the goods or documents controlling their disposition at the buyer's disposal in accordance with the contract and this Convention. The seller may make such payment a condition for handing over the goods or documents.

(2) If the contract involves carriage of the goods, the seller may dispatch the goods on terms whereby the goods, or documents controlling their disposition, will not be handed over to the buyer except against payment of the price.

(3) The buyer is not bound to pay the price until he has had an opportunity to examine the goods, unless the procedures for delivery or payment agreed upon by the parties are inconsistent with his having such an opportunity.

Article 41

The buyer must pay the price on the date fixed by or determinable from the contract and this Convention without the need for any request or other formality on the part of the seller.

Section II. Taking delivery

Article 42

The buyer's obligation to take delivery consists:

(*a*) In doing all the acts which could reasonably be expected

* Ghana, the Philippines and the Union of Soviet Socialist Republics expressed formal reservations to this article.

of him in order to enable the seller to make delivery; and

(*b*) In taking over the goods.

Section III. Remedies for breach of contract by the buyer

Article 43

(1) If the buyer fails to perform any of his obligations under the contract and this Convention, the seller may:

(*a*) Exercise the rights provided in articles 44 to 47;

(*b*) Claim damages as provided in articles 56 to 59.

(2) The seller is not deprived of any right he may have to claim damages by exercising his right to other remedies.

(3) No period of grace may be granted to the buyer by a court or arbitral tribunal when the seller resorts to a remedy for breach of contract.

Article 44

The seller may require the buyer to pay the price, take delivery or perform his other obligations, unless the seller has resorted to a remedy which is inconsistent with such requirement.

Article 45

(1) The seller may fix an additional period of time of reasonable length for performance by the buyer of his obligations.

(2) Unless the seller has received notice from the buyer that he will not perform within the period so fixed, the seller may not, during that period, resort to any remedy for breach of contract. However, the seller is not deprived thereby of any right he may have to claim damages for delay in the performance.

Article 46

(1) The seller may declare the contract avoided:

(*a*) If the failure by the buyer to perform any of his obligations under the contract and this Convention amounts to a fundamental breach of contract; or

(*b*) If the buyer has not, within the additional period of time fixed by the seller in accordance with paragraph (1) of article 45, performed his obligation to pay the price or taken delivery of the goods, or if he has declared that he will not do so within the period so fixed.

(2) However, in cases where the buyer has paid the price, the seller loses his right to declare the contract avoided if he has not done so:

(*a*) In respect of late performance by the buyer, before the seller has become aware that performance has been rendered; or

(*b*) In respect of any breach other than late performance, within a reasonable time after he knew or ought to have known of such breach, or within a reasonable time after the expiration of any additional period of time fixed by the seller in accordance with paragraph (1) of article 45 or the declaration by the buyer that he will not perform his obligations within such an additional period.

Article 47

(1) If under the contract the buyer is to specify the form, measurement or other features of the goods and he fails to make such specification either on the date agreed upon or within a reasonable time after receipt of a request from the seller, the seller may, without prejudice to any other rights he may have, make the specification himself in accordance with any requirement of the buyer that may be known to him.

(2) If the seller makes the specification himself, he must inform the buyer of the details thereof and must fix a reasonable time within which the buyer may make a different specification. If the buyer fails to do so after receipt of such a communication, the specification made by the seller is binding.

CHAPTER V. PROVISIONS COMMON TO THE OBLIGATIONS OF THE SELLER AND OF THE BUYER

Section I. Anticipatory breach and instalment contracts

Article 48

(1) A party may suspend the performance of his obligations if it is reasonable to do so because, after the conclusion of the contract, a serious deterioration in the ability to perform or in the creditworthiness of the other party or his conduct in preparing to perform or in actually performing the contract gives good grounds to conclude that the other party will not perform a substantial part of his obligations.

(2) If the seller has already dispatched the goods before the grounds described in paragraph (1) of this article become evident, he may prevent the handing over of the goods to the buyer even though the buyer holds a document which entitles him to obtain them. This paragraph relates only to the rights in the goods as between the buyer and the seller.

(3) A party suspending performance, whether before or after dispatch of the goods, must immediately give notice to the other party thereof and must continue with performance if the other party provides adequate assurance of his performance.

Article 49

If prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach, the other party may declare the contract avoided.

Article 50

(1) In the case of a contract for delivery of goods by instalments, if the failure of one party to perform any of his obligations in respect of any instalment constitutes a fundamental breach with respect to that instalment, the other party may declare the contract avoided with respect to that instalment.

(2) If one party's failure to perform any of his obligations in respect of any instalment gives the other party good grounds to conclude that a fundamental breach will occur with respect to future instalments, he may declare the contract avoided for the future, provided that he does so within a reasonable time.

(3) A buyer, avoiding the contract in respect of any delivery, may, at the same time, declare the contract avoided in respect of deliveries already made or of future deliveries if, by reason of their interdependence, those deliveries could not be used for the purpose contemplated by the parties at the time of the conclusion of the contract.

Section II. Exemptions

Article 51

(1) A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided it or its consequences.

(2) If the party's failure is due to the failure by a third person whom he has engaged to perform the whole or a part of the contract, that party is exempt from liability only if he is exempt under paragraph (1) of this article and if the person whom he has engaged would be so exempt if the provisions of that paragraph were applied to him.

(3) The exemption provided by this article has effect only for the period during which the impediment exists.

(4) The party who fails to perform must give notice to the other party of the impediment and its effect on his ability to perform. If the notice is not received within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, he is liable for damages resulting from such non-receipt.

(5) Nothing in this article prevents either party from exercising any right other than to claim damages under this Convention.

Section III. Effects of avoidance

Article 52

(1) Avoidance of the contract releases both parties from their obligations thereunder, subject to any damages which may be due. Avoidance does not affect any provisions of the contract for the settlement of disputes or any other provisions of the contract governing the respective rights and obligations of the parties consequent upon the avoidance of the contract.

(2) If one party has performed the contract either wholly or in part, he may claim from the other party restitution of whatever he has supplied or paid under the contract. If both parties are bound to make restitution, they must do so concurrently.

Article 53

(1) The buyer loses his right to declare the contract avoided or to require the seller to deliver substitute goods if it is impossible for him to make restitution of the goods substantially in the condition in which he received them.

(2) Paragraph (1) of this article does not apply:

(*a*) If the impossibility of making restitution of the goods or of making restitution of the goods substantially in the condition in which he received them is not due to an act or omission of the buyer; or

(*b*) If the goods or part of the goods have perished or deteriorated as a result of the examination provided for in article 22; or

(*c*) If the goods or part of the goods have been sold in the normal course of business or have been consumed or transformed by the buyer in the course of normal use before he discovered the lack of conformity or ought to have discovered it.

Article 54

The buyer who has lost the right to declare the contract avoided or to require the seller to deliver substitute goods in accordance with article 53 retains all other remedies.

Article 55

(1) If the seller is bound to refund the price, he must also pay interest thereon from the date on which the price was paid.

(2) The buyer must account to the seller for all benefits which he has derived from the goods or part of them:

(*a*) If he must make restitution of the goods or part of them; or

(*b*) If it is impossible for him to make restitution of all or part of the goods or to make restitution of all or part of the goods substantially in the condition in which he received them, but he has nevertheless declared the contract avoided or required the seller to deliver substitute goods.

Section IV. Damages

Article 56

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters which he then knew or ought to have known, as a possible consequence of the breach of contract.

Article 57

If the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction and any further damages recoverable under the provisions of article 56.

Article 58

(1) If the contract is avoided and there is a current price for the goods, the party claiming damages may, if he has not made a purchase or resale under article 57, recover the difference between the price fixed by the contract and the current price at the time he first had the right to declare the contract avoided and any further damages recoverable under the provisions of article 56.

(2) For the purposes of paragraph (1) of this article, the current price is the price prevailing at the place where delivery of the goods should have been made or, if there is no current price at that place, the price at another place which serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods.

Article 59

The party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount which should have been mitigated.

Section V. Preservation of the goods

Article 60

If the buyer is in delay in taking delivery of the goods and the seller is either in possession of the goods or otherwise able to control their disposition, the seller must take such steps as are reasonable in the circumstances to preserve them. He may retain them until he has been reimbursed his reasonable expenses by the buyer.

Article 61

(1) If the goods have been received by the buyer and he intends to reject them, he must take such steps as are reasonable in the circumstances to preserve them. He may retain them until he has been reimbursed his reasonable expenses by the seller.

(2) If goods dispatched to the buyer have been placed at his disposal at their destination and he exercises the right to reject them, he must take possession of them on behalf of the seller, provided that he can do so without payment of the price and without unreasonable inconvenience or unreasonable expense. This provision does not apply if the seller or a person authorized to take charge of the goods on his behalf is present at the destination.

Article 62

The party who is bound to take steps to preserve the goods may deposit them in a warehouse of a third person at the expense of the other party provided that the expense incurred is not unreasonable.

Article 63

(1) The party who is bound to preserve the goods in accordance with articles 60 or 61 may sell them by any appropriate means if there has been an unreasonable delay by the other party in taking possession of the goods or in taking them back or in paying the cost of preservation, provided that notice of the intention to sell has been given to the other party.

(2) If the goods are subject to loss or rapid deterioration or their preservation would involve unreasonable expense, the party who is bound to preserve the goods in accordance with articles 60 or 61 must take reasonable measures to sell them. To the extent possible he must give notice to the other party of his intention to sell.

(3) The party selling the goods has the right to retain out of the proceeds of sale an amount equal to the reasonable expenses of preserving the goods and of selling them. He must account to the other party for the balance.

CHAPTER VI. PASSING OF RISK

Article 64

Loss or damage to the goods after the risk has passed to the buyer does not discharge him from his obligation to pay the price, unless the loss or damage is due to an act or omission of the seller.

Article 65

(1) If the contract of sale involves carriage of the goods and the seller is not required to hand them over at a particular destination, the risk passes to the buyer when the goods are handed over to the first carrier for transmission to the buyer. If the seller is required to hand the goods over to a carrier at a particular place other than the destination, the risk does not pass to the buyer until the goods are handed over to the carrier at that place. The fact that the seller is authorized to retain documents controlling the disposition of the goods does not affect the passage of risk.

(2) Nevertheless, if the goods are not clearly marked with an address or otherwise identified to the contract, the risk does not pass to the buyer until the seller sends the buyer a notice of the consignment which specifies the goods.

Article 66

The risk in respect of goods sold in transit is assumed by the buyer from the time the goods were handed over to the carrier who issued the documents controlling their disposition. However, if at the time of the conclusion of the contract the seller knew or ought to have known that the goods had been lost or damaged and he has not disclosed such fact to the buyer, such loss or damage is at the risk of the seller.

Article 67

(1) In cases not covered by articles 65 and 66 the risk passes to the buyer when the goods are taken over by him or, if he does not do so in due time, from the time when the goods are placed at his disposal and he commits a breach of contract by failing to take delivery.

(2) If, however, the buyer is required to take over the goods at a place other than any place of business of the seller, the risk passes when delivery is due and the buyer is aware of the fact that the goods are placed at his disposal at that place.

(3) If the contract relates to a sale of goods not then identified, the goods are deemed not to be placed at the disposal of the buyer until they have been clearly identified to the contract.

Article 68

If the seller has committed a fundamental breach of contract, the provisions of articles 65, 66 and 67 do not impair the remedies available to the buyer on account of such breach.

D. *General conditions of sale and standard contracts*

36. The Commission, at its 185th meeting on 17 June 1977,[11] considered paragraphs 4 to 8 of the report of Committee of the Whole II (annex II to the present report) and, on the recommendation of the Committee, adopted the following decision:

The United Nations Commission on International Trade Law

Decides to postpone work on "general" general conditions and to review the matter when it considers, at its eleventh session, the proposals of the Secretary-General for its long-term programme of work.

CHAPTER III. INTERNATIONAL PAYMENTS

A. *Security interests*[12]

37. The Commission, at its 185th meeting, on 17 June 1977, considered paragraphs 9 to 16 of the report of Committee of the Whole II (annex II to the present report) and, on the recommendation of the Committee, adopted the following decision:

The United Nations Commission on International Trade Law

Requests the Secretary-General:

(*a*) To submit to the Commission at its twelfth session a further report on the feasibility of uniform rules on security interests and on their possible content, taking into account the comments and suggestions made in the Commission;

(*b*) To carry out further work on the subject in consultation with interested international organizations and banking and trade institutions, and in particular to ascertain the practical need and relevance of an international security interest for international trade.

B. *Contract guarantees*[13]

38. The Commission considered paragraphs 18 to 21 of the report of Committee of the Whole II (annex II to the present report) and, on the recommendation of the Committee, decided to review the item of contract guarantees at its eleventh session when the work of the International Chamber of Commerce on contract guarantees will have been concluded.

CHAPTER IV. INTERNATIONAL COMMERCIAL ARBITRATION

Recommendations of the Asian-African Legal Consultative Committee[14]

39. The Commission, at its 185th meeting on 17 June 1977, considered paragraphs 27 to 37 of the report of Committee of the Whole II (annex II to the present report) and, on the recommendations of the Committee, adopted the following decision:

The United Nations Commission on International Trade Law,

Having noted the recommendation of the Asian-African Legal Consultative Committee taken at its seventeenth session at Kuala Lumpur, on 5 July

[11] A summary record of this meeting is contained in A/CN.9/SR.185.

[12] The Commission considered this subject at its 185th meeting on 17 June 1977; a summary record of this meeting is contained in A/CN.9/SR.185.

[13] *Idem.*

[14] The Commission considered this subject at its 185th meeting on 17 June 1977; a summary record of this meeting is contained in A/CN.9/SR.185.

1976, set forth in the note by the Secretary-General (A/CN.9/127)* and the note by the Secretariat commenting on that recommendation (A/CN.9/127, Add.1),

Recalling that the Commission, at its sixth session, recommended that the General Assembly should invite the States which have not ratified or acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 to consider the possibility of adhering thereto, and that the General Assembly, by resolution 3108 (XXVIII) of 12 December 1973, made a recommendation to that effect,

Recalling also that the General Assembly, by resolution 31/98 of 15 December 1976 on the Arbitration Rules of the United Nations Commission on International Trade Law, recommended the use of the UNCITRAL Arbitration Rules in the settlement of disputes arising in the context of international commercial relations, particularly by reference to such Arbitration Rules in commercial contracts,

1. *Welcomes* the recommendation of the Asian-African Legal Consultative Committee that the States of the Asian-African region which have not ratified or acceded to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards consider the possibility of ratification or accession to that Convention;

2. *Expresses its appreciation* to the Asian-African Legal Consultative Committee for recommending that the UNCITRAL Arbitration Rules should be used in the settlement of disputes arising in the context of international commercial relations;

3. *Expresses the view* that the matters brought to the attention of the Commission by the Asian-African Legal Consultative Committee deserve thorough study and consideration, taking into account all of their aspects and implications;

4. *Requests* the Secretary-General to prepare, in consultation with the Asian-African Consultative Legal Committee, studies on these matters, taking into account the discussions and views expressed in the Commission and seeking, where necessary, information from Governments and interested international organizations and arbitration centres, including the International Council for Commercial Arbitration, and to submit such studies if possible at the eleventh session of the Commission.

CHAPTER V. LIABILITY FOR DAMAGE CAUSED BY PRODUCTS INTENDED FOR OR INVOLVED IN INTERNATIONAL TRADE

40. The Commission considered paragraphs 38 to 46 of the report of Committee of the Whole II (annex II of the present report).[15]

41. Two representatives disagreed with the recommendation of the Committee that the Commission should not pursue work on the subject of products liability at this time and that the matter should be reviewed in the context of the Commission's future programme of work at a future session if one or more Member States of the Commission should take an initiative to that effect. These representatives considered that work on this subject-matter should continue in view of its importance to developing countries which were important consumers of manufactured products.

42. However, according to another view it was preferable to reconsider the matter in the context of the Commission's new long-term programme of work. It was pointed out that the recommendation of the Committee expressly provided for the mattter to be reviewed if one or more Member States took an initiative to that effect.

43. One representative stated that the subject of products liability was more appropriately regulated on a national, rather than an international, basis. The valuable and informative report of the Secretary-General on "liability for damage caused by products involved in international trade" (A/CN.9/133)* could be used by any country which wished to draft national legislation dealing with the question of products liability.

Decision of the Commission

44. The Commission, at its 185th meeting on 17 June 1977, decided to adopt the recommendation of the Committee that it not pursue work on the subject of products liability at this time and that the matter be reviewed in the context of its future programme of work at a future session if one or more Member States of the Commission should take an initiative to that effect.

CHAPTER VI. TRAINING AND ASSISTANCE IN THE FIELD OF INTERNATIONAL TRADE LAW

Second UNCITRAL Symposium[16]

45. The Commission, at its 185th meeting on 17 June 1977, considered paragraphs 48 to 54 of the report of Committee of the Whole II (annex II to the present report) and, on the recommendation of the Committee, adopted the following decision:

The United Nations Commission on International Trade Law,

Recalling the great importance attached by the United Nations Commission on International Trade Law to its programme of training and assistance in the field of international trade law and the widespread and consistent interest expressed by Governments, especially those of developing countries, in the continuation of that programme,

Recognizing that the principal feature of such programme of training and assistance in the field of international trade law is the symposia on international trade law which the Commission has organized, and plans to organize, in connexion with its sessions,

Recalling further that the Commission has hitherto attempted to finance such symposia by soliciting voluntary contributions from Governments and other sources,

Noting that the Second UNCITRAL Symposium on International Trade Law which the Commission had planned to hold in connexion with its tenth session had to be cancelled for insufficiency of funds,

* Reproduced in this volume, part two, III.

[15] The Commission considered this subject at its 185th meeting on 17 June 1977; a summary record of this meeting is contained in A/CN.9/SR.185.

* Reproduced in this volume, part two, IV.

[16] *Idem.*

Being convinced of the need to find alternative means of financing the UNCITRAL symposia which would place this activity on a more secure financial footing,

1. *Recommends* to the General Assembly that it should consider the possibility of providing for the funding of the Commission's symposia on international trade law, in whole or in part, out of the regular budget of the United Nations;

2. *Decides:*

(*a*) That, if sufficient funds are then available, the second UNCITRAL Symposium on International Trade Law shall be held in connexion with its twelfth session;

(*b*) To consider, at its eleventh session, whether the themes of the Symposium selected at its ninth session, namely, "Transport and financing documents used in international trade" and "UNCITRAL Arbitration Rules", should be retained;

3. *Invites* the Secretary-General to continue his efforts to solicit funds from international organizations and foundations and from private sources to supplement such funds as may be provided under the regular budget of the United Nations.

CHAPTER VII. FUTURE WORK

A. *Dates and places of sessions of the Commission and its Working Groups*[17]

46. The Commission approved the following scheduling of the sessions of its Working Groups:

(*a*) Working Group on the International Sale of Goods: ninth session to be held at Geneva from 19 to 30 September 1977 and, if necessary, tenth session to be held at New York from 3 to 13 January 1978.

(*b*) Working Group on International Negotiable Instruments: fifth session to be held at New York from 18 to 29 July 1977 and the sixth session to be held at Geneva from 3 to 13 January 1978.

47. The Commission decided to hold its eleventh session in New York from 5 to 23 June 1978 provided that the Working Group on the International Sale of Goods, at its ninth session in September 1977, completed its work on the preparation of draft provisions on the formation and validity of contracts for the international sale of goods. However, it was generally considered that if the Working Group did not complete its task at its ninth session then the duration of the Commission's eleventh session should be less than three weeks. The Commission requested the Secretary to reduce in that event the length of the session and to inform Member States thereof before 31 December 1977.

B. *United Nations Conference of Plenipotentiaries on the Carriage of Goods by Sea*[18]

48. The representative of the Federal Republic of Germany informed the Commission that the Permanent Representative of his Government to the United Nations had, by a letter dated 1 June 1977, conveyed to the Secretary-General an invitation by his Government to hold the United Nations Conference of Plenipotentiaries on the Carriage of Goods by Sea in Hamburg in March 1978. His Government sincerely hoped that the United Nations would be in a position to accept this invitation which reflected his Government's deep commitment to UNCITRAL's work in this field. His Government was confident that these efforts would culminate in the adoption at the Conference of a modern world-wide convention on the carriage of goods by sea.

49. In connexion with the fact that the Conference of Plenipotentiaries on the Carriage of Goods by Sea was to be held in March 1978, the question was raised whether the Secretariat would be able to circulate all documents in all languages in good time before the beginning of the Conference. In reply to this question, the Secretary of the Commission stated that he would be able to circulate all available comments and observations of Governments and interested international organizations, and an analysis thereof, by the end of 1977 or earlier if possible.

50. The Commission took note of the invitation by the Federal Republic of Germany.

51. The representative of the Philippines informed the Commission of the interest which his Government attached to the convening of a United Nations Conference on the Carriage of Goods by Sea in his country. However, his Government was not, at this time, in a position to issue a formal invitation.

C. *Agenda for the eleventh session of the Commission*[19]

52. The Commission was agreed that at its eleventh session the following items should be considered: the draft provisions on the formation and validity of contracts for the international sale of goods if they should be completed by the Working Group on the International Sale of Goods in September 1977; the proposals of the Secretary-General for the long-term programme of work for the Commission; studies on aspects of commercial arbitration as set forth in the report of the Committee of the Whole II; and such other matters which the Secretary may wish to place before it.

D. *Co-ordination of work*[20]

53. The Commission heard a statement on this matter by the Secretary-General of the International Institute for the Unification of Private Law (UNIDROIT), in which he recalled successive resolutions of the General Assembly, particularly resolution 31/99 of 15 December 1976, calling for continued collaboration between the Commission and other organizations which were active in the field of the Commission's interest.

54. Although there had in the past been collaboration between the Commission and UNIDROIT, it was not time to give more concrete form to such collaboration, particularly in view of the continued expansion of the scope of work of the Commission. This was neces-

[17] The Commission considered this subject at its 184th and 186th meetings on 15 June and 17 June 1977, respectively; summary records of these meetings are contained in A/CN.9/SR.184 and A/CN.9/SR.186.

[18] *Idem.*

[19] *Idem.*

[20] The Commission considered this matter at its 186th meeting on 17 June; a summary record of this meeting is contained in A/CN.9/SR.186.

sary if only to avoid duplication and wastage of efforts between organizations having similar long-term objectives. His organization particularly appreciated the role which the Commission, as the most widely representative body engaged in the work of unification of private law, could play in this field. He would, therefore, propose the setting up of a consultative group composed of the representatives of the secretariats of the Commission, UNIDROIT and possibly of the Hague Conference on Private International Law, whose function would be to promote and co-ordinate collaboration between these bodies.

55. All representatives who spoke on the matter paid tribute to the contribution by UNIDROIT to the cause of unification of private law and more particularly its contribution to the success of a number of the Commission's projects. They also welcomed UNIDROIT's proposal for more effective collaboration between the Commission's secretariat and those of UNIDROIT and other appropriate organizations, and authorized the secretariat to enter into consultation with these bodies.

56. The Secretary of the Commission informed the Commission that the secretariat was approaching various interested bodies and organizations in various regions of the world for the purpose of consultations in respect of the future work programme of the Commission.

CHAPTER VIII. OTHER BUSINESS

A. *General Assembly resolutions*

57. The Commission took note of the following General Assembly resolutions:[21]

(*a*) Resolution 31/98 of 15 December 1976 on the Arbitration Rules of the United Nations Commission on International Trade Law;[22]

(*b*) Resolution 31/99 of 15 December 1976 on the report of the United Nations Commission on International Trade Law;

(*c*) Resolution 31/100 of 15 December 1976 on a United Nations Conference on the Carriage of Goods by Sea;

(*d*) Resolution 31/194 of 22 December 1976 on the utilization of office accommodation and conference facilities at the Donaupark Center in Vienna.

B. *Participation at United Nations Conference of Plenipotentiaries on the Carriage of Goods by Sea*

58. The Commission took note of General Assembly resolution 31/100 on the United Nations Conference on the Carriage of Goods by Sea. The Commission noted that in paragraph 4 (*g*) the General Assembly requested the Secretary-General to invite the specialized agencies, the International Atomic Energy Agency, as well as interested organs of the United Nations and interested regional intergovernmental organizations, to be represented at the Conference by observers. The Commission was of the view that the phrase "interested regional intergovernmental organizations" in that paragraph excluded non-governmental organizations, such as the International Chamber of Commerce, and that it also seemed doubtful if it covered such intergovernmental organizations as UNIDROIT and the Hague Conference on Private International Law. The Commission decided to draw the attention of the General Assembly to the desirability of requesting the Secretary-General to invite also interested governmental and non-governmental organizations, in particular those organizations that had participated in the Commission's work on the subject.

C. *Possible transfer of the International Trade Law Branch from New York to Vienna*

59. With respect to General Assembly resolution 31/194, the Commission noted that the General Assembly, by that resolution, had authorized the Secretary-General to put into effect, among other things, the proposal contained in paragraph 41 of his report on the utilization of office accommodation and conference facilities at the Donaupark Centre in Vienna (A/C.5/31/34), which mentions the International Trade Law Branch as one of the units to be considered for possible transfer from New York to Vienna in 1979. In view of the fact that the International Trade Law Branch functions as the secretariat of the Commission, the Commission held an exchange of views concerning the effect of the proposed transfer on its work, and it was agreed that the report on the work of its tenth session should reflect the views expressed by delegations.

60. Opinions were divided on the question whether it was proper for the Commission to express its opinion on the General Assembly resolution at issue.

61. According to one view, since the Secretary-General had been authorized by the General Assembly to put his proposal to transfer the Commission's secretariat to Vienna into effect, it was no longer open for the Commission, as an organ of the General Assembly, to seek to discuss the issue or to express views contrary to the policy decisions embodied in the pertinent resolution. This was particularly so since that resolution must be taken to embody the result of the deliberations of all Member States, including those represented by representatives to the current session of the Commission. Furthermore, at issue was an administrative and budgetary matter, and it was outside the legal competence of the Commission to interfere in such a matter.

62. According to another view, the Commission was not precluded from expressing its views on the question. The Commission's primary competence with respect to matters relating to the unification and harmonization of trade law had been recognized in its mandate. Since it must be taken as given that both the General Assembly and the Secretary-General were interested in the continued success of the Commission's work, it was not improper, but on the contrary justified, for the Commission, within its area of recognized competence, to bring to the attention of the General Assembly and the Secretary-General any factors which it felt might have an adverse effect on its ability to carry out its mandate effectively, even if such factors arose from a decision of the Secretary-General which had been approved by the General Assembly.

63. In the course of the discussions, two separate

[21] The Commission considered these resolutions at its 184th meeting, on 15 June 1977; a summary record of this meeting is contained in A/CN.9/SR.184.

[22] See also paras. 22 to 25 of the report of Committee of the Whole II (annex II to the present report).

issues were identified with regard to the planned relocation of the Commission's secretariat in Vienna: the effect of that relocation, firstly on the Commission's work, and, secondly, on the venue of the Commission's sessions.

64. As to the first issue, several representatives expressed concern that the proposed transfer might adversely affect the ability of the secretariat to function at the level of effectiveness and competence which the Commission had come to expect of it. In this connexion, it was observed that sound preparatory work in respect of the technically complex areas with which the Commission was dealing was fundamental to the success of any work in the unification of law and that the favourable reception which had so far been accorded to the work of the Commission reflected the thorough preparatory work carried out by the secretariat. Accordingly, it was considered essential that adequate research facilities be readily accessible and be available in the working languages of the Commission.

65. The representative of Austria, speaking in this context, informed the Commission that his Government was aware of the importance of research facilities to the work of the Commission. The appropriate Austrian authorities were actively exploring all possible means, including financial, that would provide the Commission and its secretariat with such facilities. Contacts had been established between representatives of the Austrian Government and the Commission's secretariat to ascertain the latter's needs in this regard and these would continue in the months ahead.

66. On the question of where the Commission would hold its sessions in the event of a transfer of its secretariat to Vienna, most representatives who spoke on the matter urged the retention of New York as one of the regular meeting places. It was recalled in this connexion that it had been the understanding when the Commission was established that it would hold its sessions on a regular basis alternately in New York and in Geneva. The principle of rotation, it was urged, should be respected.

67. Many representatives expressed support for holding the sessions alternately between New York and Vienna, although the view was also advanced that the sessions might rotate between New York, Vienna and Geneva. There was, however, consensus that the Commission should not take an official stand on this question at this time either because it would be premature to do so since everything was based on a contingency — the relocation to Vienna of the secretariat — which would at any event not materialize until after the next session or because the question involved certain complex and delicate issues which required particular consideration.

68. The Commission concluded its consideration of the question of venue without formal decisions but with the understanding that the matter would again be considered at its next session.

D. *Report of the Secretary-General on current activities of other international organizations*

69. The Commission took note of the report of the Secretary-General on this item (A/CN.9/129 and Add.1).*

* Reproduced in this volume, part two, VI.

ANNEX I

Report of Committee of the Whole I relating to the draft Convention on the International Sale of Goods

I. Introduction

1. The Committee of the Whole I was established by the Commission at its 180th meeting, on 23 May 1977. The Committee met under the chairmanship of Mr. Gyula Eörsi (Hungary) and held 32 meetings. At its 4th meeting, on 25 May 1977, the Committee elected Mr. Jorge Barrera-Graf (Mexico) as Rapporteur.

2. Under the terms of reference given to it by the Commission, the Committee was requested to consider the draft Convention on the International Sale of Goods as adopted by the Commission's Working Group on the International Sale of Goods. The text of the draft Convention is set forth in annex I to the report of the Working Group on the work of its seventh session (A/CN.9/116).* A commentary on the articles of the draft Convention may be found in annex II to that report.

3. In the course of its discussions, the Committee gave consideration to the comments on the draft Convention submitted by Governments and international organizations. These comments are set forth in A/CN.9/125 and Add.1 to 3.** An analysis of these comments, except those set forth in addenda 2 and 3, is contained in A/CN.9/126.**

4. A summary of the Committee's discussions in respect of the articles of the draft Convention and its recommendations to the Commission are set forth in paragraphs 13 to 561 of this report. At the beginning of the summary of discussions on each article, the text of that article as adopted by the Working Group on the International Sale of Goods, is reproduced.

5. At its 3rd meeting, on 24 May 1977, the Committee established a Drafting Group composed of the representatives of Colombia, Czechoslovakia, France, Mexico, Nigeria, Singapore, the Union of Soviet Socialist Republics, the United Kingdom of Great Britain and Northern Ireland and the United States of America. The Drafting Group was requested to redraft those articles of the draft Convention in respect of which modifications of substance had been agreed upon in the Committee, to consider drafting proposals submitted by Governments and international organizations in their written comments and in the course of the Committee's discussions and, generally, to examine the text of the draft Convention from the point of view of consistency of the terminology used and to ensure consistency between language versions.

6. The Committee also established several *ad hoc* groups for the purpose of reaching consensus or compromise on important legal issues dealt with in the draft Convention.

7. The Committee did not have sufficient time to consider the draft text proposed by the Drafting Group. It was noted that the Committee had considered in detail each individual article of the draft Convention and that the Drafting Group had based its work on the decisions taken and the conclusions reached in the Committee. The Committee therefore adopted the text of the draft Convention as revised by the Drafting Group with the changes described in paragraph 9 below.

8. The text of each article of the draft Convention, as recommended by the Committee for approval by the Commission, is set forth after the summary of the discussions on that article.

9. The Committee noted that the Drafting Group had placed two portions of the text in square brackets in order to bring them to the special attention of the Commitee:

(*a*) The Committee deleted, in paragraph (1) of article 23, the words "[in the circumstances]" which appear within the expression "after he has discovered it or ought [in the circumstances] to have discovered it". In its original discussion the Committee had requested the Drafting Group to consider includ-

* Yearbook ... 1976, part two, I.

** Reproduced in this volume, part two, I.

ing this expression in the text. However, the Drafting Group queried whether the expression should be included because, although the length of the period clearly depended on the circumstances of the case, the insertion of this expression in only one article could lead to a contrary conclusion in other articles of the draft Convention which did not use this expression in relation to other time-limits imposed on the parties. The Committee agreed with this reasoning.

(*b*) The Committee deleted the square brackets which the Drafting Group had placed around article 25 (2). The Drafting Group had taken this action in order to bring to the attention of the Committee the question whether it wished to have a provision on notice in article 25. The Committee decided to have such a provision and accordingly removed the square brackets. Two representatives indicated that they preferred to retain the square brackets as they were opposed to the substance of the provision.

10. The Committee also accepted the recommendation of the Drafting Group to reverse the order of articles 48 and 49 and authorized the Secretary-General to renumber the articles of the draft Convention.

11. The Committee recommends that the Commission should request the Secretary-General: (*a*) to prepare, under his own authority, a Commentary on the draft Convention; and (*b*) to suggest titles for each article by inserting such titles in the Commentary.

12. The Committee approved this report at its 32nd meeting, on 17 June 1977.

II. Deliberations and Decisions

Draft Convention on the International Sale of Goods

PART I. SUBSTANTIVE PROVISIONS

Chapter I. Sphere of application

ARTICLE 1

13. The text of article 1, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) This Convention applies to contracts of sale of goods entered into by parties whose places of business are in different States:

"(*a*) When the States are Contracting States; or

"(*b*) When the rules of private international law lead to the application of the law of a Contracting State.

"(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract."

Paragraph (1)

Basic criterion

14. The Committee considered a proposal that would narrow the basic criterion for the application of the Convention by requiring that the parties to a contract of sale, besides having their places of business in different States, should also be of different nationalities. The purpose of this proposal was to ensure that, if buyer and seller were of the same nationality, their national law would apply, even if the place of business of the buyer was in a State other than the State in which the seller's place of business was situated.

15. The Committee did not retain this proposal on the grounds that the determination of nationality, particularly in relation to corporations, was a complex issue over which national laws differed. In addition, the nationality of the other party may not be evident to each party at the time of contracting. Accordingly, the adoption of the nationality requirement would greatly complicate the task of determining whether the Convention applied and could thus lead to uncertainty.

Places of business

16. Two proposals were made in regard to the concept of "places of business". Under one proposal, that concept should be replaced by the concept of "residence" since the test of "places of business" of the parties could have considerable disadvantages in practice. For example, if two enterprises having their residence in the same country had places of business in different countries the Convention would apply. After deliberation, the Committee decided not to retain the proposal on the grounds that the test of "residence" would not simplify the determination of whether the Convention applied and would, in some cases, not be appropriate. The Committee also did not retain a second proposal under which the relevant places of business of the parties should be limited to their "main" places of business. The Committee's views in this respect are set forth under article 6 (*a*).*

Subparagraph (1) (a)

17. The Committee considered, but did not retain, a proposal that it should be sufficient for the Convention to apply if one of the States in which the parties have their places of business was a Contracting State. The Committee noted that the present text reflected the approach of article 3 of the Convention on the Limitation Period in the International Sale of Goods, hereinafter referred to as the "Convention on the Limitation Period", and that the requirement that the States in which the parties have their places of business be Contracting States was preferable since it was based on the principle of reciprocity.

Subparagraph (1) (b)

18. Subparagraph (1) (*b*) provides that the Convention is applicable if the rules of private international law of the forum leads to the application of the law of a Contracting State and that, in such a case, it is immaterial whether the place of business of one or both parties is in a Contracting State.

19. The Committee considered two proposals which were addressed to this issue. Under the first proposal, subparagraph (*b*) should be deleted; under the second proposal, the Convention should be attracted only if the rules of private international law of a Contracting State led to its application.

20. Neither of these proposals commanded sufficient support in the Committee to be retained and the Committee recommends therefore to the Commission that the present wording of subparagraph (*b*) should be adopted.

Paragraph (2)

21. The Committee approved paragraph (2) without change.

Proposed paragraph (3)

22. The Committee, in its deliberations on article 6, referred to the Drafting Group the question whether article 6 (*c*) should be relocated as article 1 (1) (*c*).

Decision

23. The Committee accordingly recommends that the Commission should adopt the following text:

"Article 1

"(1) This Convention applies to contracts of sale of goods entered into by parties whose places of business are in different States:

"(*a*) When the States are Contracting States; or

"(*b*) When the rules of private international law lead to the application of the law of a Contracting State.

* Article 6 (*a*) provides that "if a party to a contract of sale of goods has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at the time of the conclusion of the contract;".

"(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.

"(3) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration."

ARTICLE 2

24. The text of article 2, as adopted by the Working Group on the International Sale of Goods, is as follows:

"This Convention does not apply to sales:

"(*a*) Of goods bought for personal, family or household use, unless the seller, at the time of the conclusion of the contract, did not know and had no reason to know that the goods were bought for any such use;

"(*b*) By auction;

"(*c*) On execution or otherwise by authority of law;

"(*d*) Of stocks, shares, investment securities, negotiable instruments or money;

"(*e*) Of ships, vessels or aircraft;

"(*f*) Of electricity."

Subparagraph (a)

Exclusion of consumer sales

25. The Committee was agreed that consumer sales should be excluded from the scope of the Convention on the ground that such transactions were, in a number of countries, subject to special laws and regulations designed to protect consumers. Such an exclusion would not significantly limit the scope of application since consumer sales would only in relatively few cases qualify as an international sale within the meaning of the Convention.

26. The Committee considered a proposal that would delete the words "unless the seller, at the time of the conclusion of the contract, did not know and had no reason to know that the goods were bought for any such use". The proposal was based on the ground that these words, which do not appear in the corresponding provision (article 4 (*a*)) of the Convention on the Limitation Period, introduced a subjective element in that it depended on the subjective view of the seller whether or not the sale was a consumer sale and, consequently, whether or not the Convention would apply.

27. The Committee was of the view that the knowledge of the seller that the contract of sale was one falling within the scope of the Convention was important. In the framework of the Convention on the Limitation Period, the parties had ample time and opportunity to establish whether the sale was a consumer sale or a commercial sale and, accordingly, to determine whether the limitation of legal proceedings and the prescription of the parties' rights against each other would, or would not, be governed by that Convention. The Committee therefore concluded that the present wording of subparagraph (*a*) should be retained.

Exclusion of sales by auction, on execution or otherwise by authority of law, and of stocks, shares, investment securities, negotiable instruments or money

28. There were no proposals made to amend or delete any of the provisions of subparagraphs (*b*), (*c*) or (*d*) and the Committee recommends that these subparagraphs should be retained in their present wording.

Exclusion of sales of ships, vessels or aircraft

29. Opinions were divided on the question whether the sale of ships, vessels and aircraft should, as under the present text, be excluded from the scope of application of the Convention.

30. Under one view, these sales should fall within the scope of the Convention because:

(*a*) The ground invoked for exclusion of these sales, namely, that vessels and aircraft are subject to special registration requirements, was not convincing since these requirements had little to do with the relations between buyer and seller. In this connexion, it was noted that the sale of pleasure craft had, in recent years, gained in importance on the international level and could, from a legal point of view, be assimilated to the sale of motor-vehicles which, though subject to registration, did fall within the scope of the Convention;

(*b*) The sale of large vessels and aircraft was usually made subject to special conditions of sale and would, under article 5, to that extent be taken out of the Convention.

31. Under another view, the exclusion of sales of ships, vessels and aircraft was justified on the ground that:

(*a*) In many legal systems, ships and aircraft, once registered, are assimilated to immovables;

(*b*) Article 4 (*e*) of the Convention on the Limitation Period excludes such sales from the scope of the Convention and a proposal made at the Conference of Plenipotentiaries at which that Convention was adopted to include such sales had been rejected.

32. The Committee, after deliberation, concluded that the issue could not be solved by a compromise text based on consensus. It therefore recommends that the Commission adopt the present text of subparagraph (*e*).

Exclusion of sales of electricity

33. The Committee considered two proposals:

(*a*) That subparagraph (*f*) be deleted so that the sale of electricity would be within the scope of the Convention; and

(*b*) To exclude from the scope of the Convention also the sale of gas.

34. The Committee did not retain the proposal for deletion of subparagraph (*f*). It noted that, in many legal systems, electricity was not considered to be a corporeal movable and that, consequently, the deletion of the subparagraph would not necessarily bring the sale of electricity within the Convention but might, on the contrary, give rise to uncertainty.

35. The Committee also did not accept the proposal that the sale of gas be assimilated to the sale of electricity and thus be excluded from the scope of the Convention. It was noted that since a considerable number of both simple and compound bodies existed in either gaseous, liquid or solid state, the sale of these goods would be excluded under the proposal or, at least, present borderline cases. The Committee was of the view that the drawing up of a list of all borderline cases would be a lengthy process and would be inadvisable. In cases where the application of the Convention to the sale of gas was not desired, the parties could, under article 5, vary the effect of any of its provisions. The Committee was therefore agreed to maintain the present wording of subparagraph (*f*).

Decision

36. The Committee concludes that no change of substance is called for in respect of article 2. It therefore recommends that the Commission should adopt the following text:

"Article 2

"This Convention does not apply to sales:

"(*a*) Of goods bought for personal, family or household use, unless the seller, at the time of the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use;

"(*b*) By auction;

"(*c*) On execution or otherwise by authority of law;

"(*d*) Of stocks, shares, investment securities, negotiable instruments or money;

"(*e*) Of ships, vessels or aircraft;

"(*f*) Of electricity."

ARTICLE 3

37. The text of article 3, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) This Convention does not apply to contracts in which the preponderant part of the obligations of the seller consists in the supply of labour or other services.

"(2) Contracts for the supply of goods to be manufactured or produced are to be considered sales unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production."

38. The Committee considered a proposal that article 3 be deleted and then considered proposals relating to paragraph (2).

Deletion of provision

39. The proposal to delete article 3 was based on the ground that the types of contract envisaged by the article fell outside the sphere of the sale of goods and that the article was therefore not appropriate in a Convention which regulated the obligations of the buyer and the seller. There was, however, a considerable body of opinion in favour of retaining article 3, particularly for the reason that the provision was useful for determining whether the Convention applied in borderline cases. It also provided a useful guideline for the courts of a number of common law countries which otherwise might assume that the Convention would apply. After deliberation, the Committee decided not to retain the proposal to delete article 3.

Paragraph (2)

40. The Committee, for the same reasons, did not retain a proposal that paragraph (2) be deleted.

41. The Committee also considered a proposal under which the words "a substantive part of the materials" were to be replaced by the words "materials or any part of them", so that, if any part of the materials were supplied by the buyer, the Convention would not apply. The proposal was based on the premise that it would not be equitable to make the seller responsible for conformity of the goods if some of the materials for the production of those goods were supplied by the buyer. In opposition to this proposal it was pointed out that the text provided a useful guideline for a number of legal systems. It was also noted that the provision followed article 6 (2) of the Convention on the Limitation Period. After deliberation, the Committee decided to retain the original text.

Relationship of article 3 (2) to seller's responsibility for defects

42. The Committee considered a proposal to amend article 3 (2) to regulate the question of the seller's responsibility for the goods in cases where the buyer has supplied less than a "substantial part" of the materials. This proposal is discussed in paragraphs 179 to 184 of the report relating to article 19.

Decision

43. The Committee concludes that no change of substance is called for in respect of article 3. It therefore recommends that the Commission should adopt the following text:

"Article 3

"(1) This Convention does not apply to contracts in which the preponderant part of the obligations of the seller consists in the supply of labour or other services.

"(2) Contracts for the supply of goods to be manufactured or produced are to be considered sales unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production."

ARTICLE 4

44. The text of article 4, as adopted by the Working Group on the International Sale of Goods, is as follows:

"This Convention also applies where it has been chosen as the law of the contract by the parties."

45. The Committee noted that article 4 was based on the premise, accepted by most legal systems, that the parties to a sales transaction were at liberty to choose the law applicable to their contract, and that the article was designed to extend the application of the Convention to contracts of sale in circumstances not envisaged by article 1.

46. The discussions in the Committee revealed that the article was not free from ambiguities and was thus open to divergent interpretations. Whilst it was generally agreed that parties were free to incorporate provisions of the Convention into their contract to the extent that these provisions did not conflict with the applicable law, opinions differed greatly on the question as to the extent to which and the circumstances in which parties could choose the Convention as the law of the contract. Amongst the issues that were raised in this context was that of the relationship of article 4 to the preceding articles of the Convention, in particular whether the article could be interpreted as permitting parties to make the Convention applicable to domestic sales contracts and to the types of contract that were excluded from the Convention by virtue of articles 2 or 3.

47. The Committee considered various proposals which, by restricting the tenor of article 4, were designed to clarify these issues. None of these proposals commanded sufficient support and were therefore not retained.

48. Under one proposal, the choice of the Convention as the law of the contract would be effective only if the contract was entered into by parties whose places of business were in different States and one of these States was a Contracting State. The purpose of this proposal was to ensure that the Convention would apply only to international sales and, by its insertion into article 1, prevent its application to sales excluded from the Convention under articles 2 or 3. However, there was significant support for the view that the proposal, if adopted, would needlessly restrict the application of the Convention, for instance in circumstances where a business firm had a branch in another State which sold goods to a buyer whose place of business was situated in that same State. Under the terms of article 6 (*a*), the parties would have their place of business in the same State and the Convention would not apply, although the transaction could be qualified as international. Adherents to the view that the parties should be able, in such a case, to choose the Convention as the law of the contract were therefore opposed to the restriction to party autonomy which the proposal sought to achieve. Consequently, the Committee did not retain this proposal.

49. Concern was, however, expressed, also amongst those opposing the proposal, that article 4, if retained, should not be used to circumvent article 2 (*a*) which expressly excluded consumer sales, since many countries had enacted consumer protection legislation governing important aspects of this type of sale.

50. The Committee did not retain a proposal, based on article 4 of the 1964 Hague Uniform Law on the International Sale of Goods (ULIS), that the Convention, if chosen as the law of the contract, would be subject to the mandatory provisions of the law that would have been applicable if the parties had not chosen the Convention.

51. At the close of the discussions on article 4, there was a considerable body of opinion in the Committee which questioned the practical need for a special provision on the lines of article 4. Whatever the parties agreed would only be valid within the limits of mandatory law.

Decision

52. The Committee concludes that article 4 raises many difficult questions of interpretation which even protracted discussions have failed to solve. Because of this, and in view of the fact that a provision on the lines of article 4 is not strictly necessary to achieve the purpose for which it was drafted, the Committee recommends to the Commission that the article should be deleted.

ARTICLE 5

53. The text of article 5, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The parties may exclude the application of this Convention or derogate from or vary the effect of any of its provisions."

54. The Committee considered a proposal that the Convention apply to a sales transaction only if it is made so applicable by the parties to the transaction. The purpose of this proposal was to facilitate accession to the Convention by States which, though viewing the Convention favourably as a whole, had reservations concerning particular issues. A subsidiary reason cited in support was that, since many rights under the Convention depended upon compliance with the Convention and the contract, it would be preferable to require that the parties expressly adopt the Convention rather than relying on article 5 to ensure that inconsistent contractual provisions will govern.

55. The proposal did not command sufficient support in the Committee and was therefore not retained. Amongst the arguments put forward against its retention was the view that to make the application of the Convention dependent upon any express stipulation by the parties would turn the Convention into a model law and would thereby remove the raison d'être of the Convention, namely, that it would apply automatically unless the parties had excluded it, or derogated from or varied the effect of any of its provisions.

56. The Committee also did not retain a proposal that the Convention may be excluded only by an express stipulation of the parties. In support of this proposal it was submitted that it should not be possible that the Convention, which was to apply as the law of the contract, could be set aside by mere implication. The suggestion was also made that the faculty which the parties had to exclude the Convention should be subject to their choosing another law of the contract to replace the Convention.

57. The proposal, and the allied suggestion, were opposed on the ground that it may be perfectly clear that the parties do not wish the Convention to apply even though this intention was not stated expressly. Another argument against the proposal was that the Convention itself envisaged exclusion or modification of its provisions by other than express means, as in article 8 on usages.

Decision

58. The Committee concludes that no change of substance is called for in respect of this article, now renumbered as article 4. It therefore recommends that the Commission should adopt the following text:

"Article 4

"The parties may exclude the application of this Convention or derogate from or vary the effect of any of its provisions."

ARTICLE 6

59. The text of article 6, as adopted by the Working Group on the International Sale of Goods, is as follows:

"For the purposes of this Convention:

"(*a*) If a party to a contract of sale of goods has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at the time of the conclusion of the contract;

"(*b*) If a party does not have a place of business, reference is to be made to his habitual residence;

"(*c*) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration."

Subparagraph (a)

(i) *Deletion of subparagraph* (a)

60. The Committee considered a proposal that article 6 (*a*) be deleted and that the introductory words of article 1 (1) be amended so that the Convention would apply to contracts entered into by parties whose *main* places of business are in different States. In support of this proposal it was pointed out that it would be simpler to determine the *main* place of business rather than ascertaining which place of business had "the closest relationship to the contract and its performance". In opposition to the proposal, it was pointed out that use of the *main* place of business departed from the concept of relationship with the contract, with the result that the Convention may be attracted to transactions wholly formed and performed in one State, e.g. if the contracting parties have their *main* places of business in different States. Similarly, the Convention may not apply to international transactions because the contracting parties have their *main* places of business in one State. It was also noted that the present text was likely to correspond to the intention of the parties. Further, it was observed that article 6 (*a*) corresponds to article 2 (*c*) of the Convention on the Limitation Period. After considerable discussion and deliberation, the Committee did not retain the proposal to delete article 6 (*a*).

(ii) *Insertion of new definition of "place of business"*

61. It was proposed that a new definition of "place of business" be formulated which did not relate "place of business" to the contract and its performance. In support of this proposal, it was stated that a clear definition would enable the relevant "place of business" to be determined at the moment of the conclusion of the contract. Such determination was difficult with the present definition which required that account be taken on the performance of the contract. A further problem was that as each party may have numerous obligations it may be difficult in practice to apply the test of "closest relationship with the contract and its performance". However, in opposition to the proposal, it was stated that article 6 (*a*) is a good indication of the intention of the parties and also gives a clear method of determining which places of business are relevant for the purposes of the Convention. It was also observed that although performance naturally occurs after the conclusion of the contract the last part of article 6 (*a*) specifically limits consideration of performance "to the circumstances known to or contemplated by the parties at the time of the conclusion of the contract". After extensive deliberations the Committee decided to reject the proposal to reformulate the definition of "place of business".

(iii) *Relationship of place of business to performance*

62. The Committee considered a proposal to delete the reference to the performance of the contract which, in the proposed text, is relevant in determining which of more than one place of business should be selected for the purposes of the Convention. The view was expressed that the concept of performance did not necessarily relate to a single act but could cover a series of actions, such as handing the goods over to a carrier and delivery to the buyer. There could thus arise an ambiguity if a branch of the seller's business, participating in the performance of the contract, were situated in the buyer's State since it might be doubtful if the Convention would be applicable. It was further argued that it was at the time of the conclusion of the contract that it was necessary to know whether it was the national law or the Convention which applied, and that this question should not be resolved in the light of subsequent circumstances.

63. In favour of retention of the reference to performance it was argued that the question at issue should be considered in the light of the last phrase of paragraph (*a*): "having regard to the circumstances known to or contemplated by the parties at the conclusion of the contract". It should be the transaction as a whole, "the contract and its performance", which should determine the relevant place of business.

64. The Committee, after deliberation, decided not to retain the proposal to delete the reference to performance.

Subparagraph (b)

65. The Committee adopted the present text after noting a proposal that rather than making reference to the habitual residence of the parties it would be preferable to clearly define the meaning of "place of business".

Subparagraph (c)

66. The Committee considered three proposals:

(i) That the substance of article 6 (*c*) be transferred to a new location as article 1 (3);

(ii) That article 6 (*c*) be deleted;

(iii) That article 6 (*c*) be separated into two articles, the first dealing with nationality and the second with the character of the parties.

(i) *Transfer of article 6* (c)

67. In support of the proposal to transfer the substance of article 6 (*c*) to a new location as article 1 (1) (*c*), it was pointed out that this change would make it possible to take into consideration the civil or commercial character of the parties or of the contract for such purposes as determining the time for sending notices to the other party. The proposal was also supported on the ground that article 6 (c) was better located in article 1 as it dealt with the sphere of application of the Convention whereas articles 6 (*a*) and (*b*) were concerned with the definition of "place of business". In opposition to the proposal, it was stated that it would be preferable to retain article 6 (*c*) in its present location so that it would conform to article 2 (*e*) of the Convention on the Limitation Period. It was also noted that since article 2 (*a*) of the Sales Convention did not exclude all consumer sales from the sphere of application of the Convention, it would be desirable to preface article 6 (*c*) by the words "except as provided in article 2 (*a*)". A representative stated that while he would not object to such a change it was on the understanding that nationality of the parties was always irrelevant, even in consumer sales.

68. After considerable discussion, the Committee referred the question of the location of article 6 (*c*) to the Drafting Committee which was also requested to consider whether article 6 (*c*) should exclude article 2 (*a*).

(ii) *Deletion of subparagraph* (c)

69. In support of the proposal to delete article 6 (*c*), it was stated that as no other article dealt with nationality or with the civil or commercial character of the parties it was superfluous to have a separate provision stating that these matters were not to be taken into consideration. In opposition to this proposal, it was noted that many civil law systems apply different standards depending on the civil or commercial nature of the parties or of the contract. Accordingly, it was helpful to have a provision which clearly indicated that these considerations did not affect the application of the Convention. Similarly, it was helpful to provide that the nationality of the parties did not affect the operation of the Convention. The proposal was also opposed on the basis that it would create unnecessary conflict with the Convention on the Limitation Period. The Committee, after deliberation, did not retain the proposal for deletion.

(iii) *Separation of article 6* (c) *into two articles*

70. In support of this proposal, it was stated that the question of the civil or commercial character of the parties, or of the contract, was distinct from the question of nationality and so should be dealt with in a separate article as was the case in ULIS (article 1 (3) and article 7). It was also suggested that the question of nationality should be dealt with in article 1 as it related to the scope of application of the Convention. The Committee referred this matter to the Drafting Committee.

Decision

71. The Committee recommends that the Commission should adopt the following text of this article, now renumbered as article 5:

"*Article 5*

"For the purposes of this Convention:

"(*a*) If a party has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at the time of the conclusion of the contract;

"(*b*) If a party does not have a place of business, reference is to be made to his habitual residence."

ARTICLE 7

72. The text of article 7, as adopted by the Working Group on the International Sale of Goods, is as follows:

"[(1)] This Convention governs only the rights and obligations of the seller and the buyer arising from a contract of sale. In particular this Convention is not, except as otherwise expressly provided therein, concerned with the formation of the contract, nor with the effect which the contract may have on the property in the goods sold, nor with the validity of the contract or of any of its provisions or of any usage.

"[(2) This Convention does not govern the rights and obligations which might arise between the seller and the buyer because of the existence in any person of rights or claims which relate to industrial or intellectual property or the like.]"[b]

Further limitations to the scope of the Convention

73. The Committee considered a proposal that additional matters be excluded from the scope of application of the Convention. In this connexion, reference was made to national legislation designed to protect the buyer in instalment sales and "door to door" sales. Not all of these types of sale were excluded under article 2 (*a*) of the Convention, but national legislation regulating these types of sales should nevertheless take precedence over the Convention.

74. The Committee did not retain this proposal on the ground that the Convention did not relate to matters of validity and that the question of whether the types of sales contract to which the proposal referred were valid would be left to national law.

Deletion of paragraph (1)

75. It was suggested that paragraph (1) be deleted since it was a declaratory provision which did not appear to serve any useful purpose. It was unusual for a Convention to specify the matters which it did not purport to settle.

76. Deletion of the provision was opposed on the ground that paragraph (1) served the purpose of preventing the Convention from overruling domestic law relating to the validity of contracts. In this connexion, reference was made to article 36 of the Convention relating to open-price contracts: the question of the validity of such contracts was, as article 7 (1) made clear, left to national law.

77. The Committee, after deliberation, did not retain the proposal to delete paragraph (1).

Deletion of paragraph (2)

78. The Committee retained a proposal to delete paragraph (2) after having decided that the matter of rights and claims relating to industrial or intellectual property should be dealt with in article 25.

Decision

79. The Committee recommends to the Commission that paragraph (1) of this article, now renumbered as article 6 should

[b] The Working Group left paragraph (2) in square brackets to indicate that it was a matter which it considered should be decided by the Commission.

be retained and that paragraph (2) should be deleted, and that, accordingly, the Commission should adopt the following text:

"Article 6

"This Convention governs only the rights and obligations of the seller and the buyer arising from a contract of sale. In particular, except as otherwise expressly provided therein, this Convention is not concerned with:

"(*a*) The formation of the contract;

"(*b*) The validity of the contract or of any of its provisions or of any usage;

"(*c*) The effect which the contract may have on the property in the goods sold."

Chapter II. General provisions

ARTICLE 8

80. The text of article 8, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.

"(2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract a usage of which the parties knew or had reason to know and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned."

Relevance of usages

81. It was noted that article 8 had not retained the provision of paragraph (2) of article 9 of ULIS according to which, in the event of conflict with the uniform law, usages would prevail unless otherwise agreed by the parties.

82. However, the view was expressed that the proposed article 8 still attached too much importance to usages and that the unification of law could well become compromised unless it was made clear that usages were only an additional faction which, in the case of implied usages, become binding on the parties only if the usage was not in conflict with the contract or the Convention.

83. The prevalent opinion in the Committee was in favour of maintaining the proposed text of article 8 and the suggestion was therefore not retained.

New paragraph (3): interpretation of trade terms

84. The Committee considered a proposal designed to reintroduce a provision along the lines of paragraph 3 of article 9 of ULIS which provides that:

"Where expressions, provisions or forms of contract commonly used in commercial practice are employed, they shall be interpreted according to the meaning usually given to them in the trade concerned."

The proposal was made on the ground that a distinction should be drawn between the application of usages, covered by paragraphs (1) and (2) of article 8, and the application of trade terms such as FOB or CIF, in respect of which there existed several interpretations.

85. The contrary view was expressed that the subject-matter of the proposed new paragraph was already covered by paragraphs (1) and (2) and was therefore unnecessary.

86. The Committee did not retain the proposal as a slight majority of views expressed were in favour of retaining the text proposed by the Working Group on the International Sale of Goods.

Decision

87. The Committee concludes that no change of substance is called for in respect of this article, now renumbered as article 7. It therefore recommends that the Commission should adopt the following text:

"Article 7

"(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.

"(2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned."

ARTICLE 9

88. The text of article 9 as adopted by the Working Group on the International Sale of Goods is as follows:

"A breach committed by one of the parties to the contract is fundamental if it results in substantial detriment to the other party and the party in breach foresaw or had reason to foresee such a result."

89. The view was expressed that the definition of fundamental breach in the proposed article was unsatisfactory in that one of the prerequisites of a fundamental breach was that the substantial detriment to the other party had been foreseen by the party in breach or that that party had reason to foresee such detriment. In cases of litigation, the burden of proof would thus be on the innocent party and this could not be considered a proper solution. In this connexion, the Committee considered and accepted the suggestion that the final phrase of the proposed article should read:

"unless the party in breach did not foresee and had no reason to foresee such a result."

90. It was noted that the proposed text did not deal with the point of time at which it was possible to foresee the result. It was pointed out that article 10 of ULIS referred to "the time of the conclusion of the contract". According to another view, it would be fairer to refer to the time at which the breach was actually committed rather than the time at which the contract was concluded. The Committee, after deliberation, did not consider it necessary to specify at what moment the party in breach should have foreseen or had reason to foresee the consequences of the breach.

91. The proposal was made that the criterion of fundamental breach should be a "loss of interest in the contract" on the part of the innocent party. This suggestion was opposed on the ground that it brought in the question of motive for entering into a contract and that this was too subjective an element. The Committee did not retain this proposal.

92. The Committee also did not retain a proposal that the text of foreseeability be deleted. It was pointed out in this connexion that article 9 was designed to avoid the cancellation of a contract for reasons which were not sufficient to warrant avoiding it.

Relationship to right of seller to cure[e]

93. During its consideration of article 29, the Committee considered a proposal that article 9 read as follows (new language in italics):

"A breach committed by one of the parties to the contract is fundamental if, *under all the circumstances, including a reasonable offer to cure,* it results in substantial detriment to the other party and the party in breach foresaw or had reason to foresee such a result."

94. In support of this proposal, it was stated that the proposed addition to article 9 would protect against technical avoidance of the contract when there had been an offer to cure under article 29. However, under another view this change was unnecessary because the conditions governing an offer by the seller to cure were governed by article 29 and, if there was no offer to cure, the situation was governed by article 9. Accordingly, the proposal was superfluous.

[e] See paras. 271 to 284 below.

95. The Committee did not retain the proposal.

Decision

96. The Committee recommends that the Commission should adopt the following text of this article, now renumbered as article 8:

"Article 8

"A breach committed by one of the parties is fundamental if it results in substantial detriment to the other party unless the party in breach did not foresee and had no reason to foresee such a result."

ARTICLE 10

97. The text of article 10 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) Notices provided for by this Convention must be made by the means appropriate in the circumstances.

"(2) A declaration of avoidance of the contract is effective only if notice is given to the other party.

"(3) If a notice of avoidance or any notice required by article 23 is sent by appropriate means within the required time, the fact that the notice fails to arrive or fails to arrive within such time or that its contents have been inaccurately transmitted does not deprive the sender of the right to rely on the notice."

Article 10 in general

98. The Committee considered a proposal that the general rule in article 10 be that communications must be received by the addressee. In support of this proposal, it was stated that this "receipt theory" accorded with principles of equity because the sender would always know if he had dispatched a notice. Consequently, if there was no reaction from the addressee he could easily take steps to ensure whether the notice had in fact arrived. In opposition to this proposal, it was pointed out that countries which utilized the "receipt theory" had supporting procedural rules which enabled the theory to work in practice since it was extremely difficult to establish whether a notice had in fact been received by the addressee. But as such procedural rules were not present in countries which utilized the "dispatch theory", it would be necessary to include them in the Convention which would complicate the text of the Convention.

99. After deliberation, the Committee decided not to adopt the "receipt theory" as the basis of article 10. However, it was understood that this decision did not preclude particular provisions from requiring that communications called for by that provision be received.

Paragraph (1)

100. The Committee considered a proposal that paragraph (1) be deleted. In support of this proposal, it was stated that paragraph (1) might be interpreted to mean that the sanction for non-compliance with its provisions is that the notice will be denied effect. However, this result would be unjust if the notice was actually received in time although it had not been sent by the "means appropriate in the circumstances". Furthermore, since the provision was designed to mean that the sender will be deprived of the benefit of article 10 (3), which relieves him from transmission hazards, it would be more appropriate to delete the provision and introduce the requirement of appropriate means of transmission directly into article 10 (3).

101. After noting the concern of an observer that it may be difficult for a judge to determine whether particular means of transmission were "appropriate", the Committee retained the proposal to delete paragraph (1) and to introduce the requirement of appropriate means of transmission directly in article 10 (3).

Paragraph (2)

102. The Committee considered proposals that the declaration of avoidance must be made by written notice to the other party or, alternatively, be immediately followed by written notice. The Committee decided to consider these proposals in connexion with article 11. The Special Drafting Group created in respect of article 11 did not retain these proposals and, therefore, the present text of paragraph (2) was retained.

103. However, the Committee referred the provision to the Drafting Group for reformulation to make it clear that prior notice of a declaration of avoidance is not required.

Paragraph (3)

104. The Committee considered a proposal that paragraph (3) be replaced by the following text:

"If any notice, request or communication provided for by this Convention is sent by means appropriate in the circumstances within the requested time, the fact that the notice fails to arrive or fails to arrive within such time or that its contents have been inaccurately transmitted does not deprive the sender of the right to rely on the notice."

105. In support of this proposal, it was stated that since the Convention required a large number of communications there should be a general provision which deals with questions of their transmission to the addressee. It was pointed out that the proposal would ensure errors in transmission or lost or delayed transmission would be treated uniformly throughout the Convention. Furthermore, a clear rule governing hazards of transmission was very important since the terminology governing the giving of notices varied considerably throughout the Convention. The present text of paragraph (3) dealt with only two situations which could give the impression that the varying terminology used throughout the Convention implied varying rules concerning whether communications must be received or merely sent. In addition, it was stated that the provision proposed in paragraph 104 above could easily be amended so as to exclude any communications for which a different rule was considered to be more appropriate.

106. There was general support for the proposal that the risk of transmission of lost or delayed notices, or errors in transmission, be governed by one article. However, it was also agreed that adoption of such a provision should be subject to any contrary provisions in the existing text or to any future contrary provisions which might be formulated during the course of the present session.

107. The Committee, after deliberation, tentatively retained this proposal by placing it within square brackets. After having examined the other provisions of the Convention, the Committee adopted the tentatively retained text with the addition of a phrase indicating that some articles contained a different rule. The Drafting Group was requested to use appropriate language which clearly indicated the reversal of the general rule established by paragraph (3) in each article that made communications effective only on receipt.

108. The Committee also considered a proposal that paragraph (3) apply to all communications required by the Convention except communications under articles 28, 29 (2), 29 (3), 44, 46 and 47 (3).

109. In support of this proposal, it was stated that the rule in paragraph (3) was appropriate to most, but not all, communications required by the Convention. In particular, article 46 and the second sentence of article 47 (3) expressly provided for the receipt of notices. In addition, it was noted that it appears inappropriate to extend the benefit of paragraph (3) to a defaulting party's request for an additional period of time to perform, or to cure defects, pursuant to articles 29 (2) and (3). The provision was also suggested to be inappropriate to articles 28 and 44.

110. In opposition to the proposal, it was argued that it would be preferable to adopt a general rule and to decide on specific exceptions when later articles were being considered.

111. After deliberation, the Committee did not retain the proposal to specifically exclude, at this stage, articles 28, 29 (2), 29 (3), 44, 46 and 47 (3) from the operation of article 10 (3).

112. The view was expressed that the article should be operative only if the addressee had no reason to know, or foresee, the error in transmission or the failure of the notice to arrive or arrive on time. There was, however, no support for this proposal.

113. The Committee further considered a proposal that paragraph (3) be limited to cases where the sender repeated the communication within a period of three months. It was stated that this would balance the rights and obligations of the contracting parties in cases where there had been lost or delayed communications or errors in transmission. The Committee did not retain this proposal for want of support.

Decision

114. The Committee accepted a recommendation of the Drafting Group that paragraphs (2) and (3) of article 10 be contained in separate articles with paragraph (2) now renumbered as article 9 and paragraph (3) as article 10. The Committee therefore recommends that the Commission should adopt the following text:

"Article 9

"A declaration of avoidance of the contract is effective only if made by notice to the other party.

"Article 10

"Unless otherwise expressly provided in this Convention, if any notice, request or other communication is given by a party in accordance with this Convention and by means appropriate in the circumstances, a delay or error in the transmission of the communication or its failure to arrive does not deprive that party of the right to rely on the communication."

ARTICLE 11

115. The text of article 11 as approved by the Working Group on the International Sale of Goods is as follows:

["A contract of sale need not be evidenced by writing and is not subject to any other requirements as to form. It may be proved by means of witnesses."][d]

116. The Committee considered a proposal for the deletion of article 11 and then considered a number of compromise proposals.

Deletion of article 11

117. It was proposed that article 11 be deleted as it related to matters of formation and validity of contracts which were outside the scope of the Convention. The view was expressed that such matters should be dealt with in a Convention on Formation or be left to the applicable national law. It was also pointed out that the Sales Convention should not concern itself with how the contents of the contract could be proved as this was a matter of procedure which was also outside its scope. However, the contrary view was expressed that it was crucial that the Convention gave a clear indication of how the contract and its contents can be established for otherwise many of the rights given by the Convention might be put at great risk. In this connexion, reference was made to article 36 on determination of the price. It was also pointed out that deletion of article 11 would be satisfactory only if the matter was in fact dealt with in an international Convention, ratified by the same parties as had ratified the Sales Convention, or if matters of formation were dealt with in the same Convention as matters regulating the rights and obligations of the parties to the contract. In addition, failure to provide a clear rule, whether it be a strict requirement for writing or a flexible approach, would cause great uncertainty to the parties to the contract who may have considerable difficulty in ascertaining national law requirements.

[d] The Working Group left this article in square brackets to indicate that it was a matter which it considered should be decided by the Commission.

118. The Committee decided, in view of the importance of the question, to consider a number of compromise proposals and to refer these proposals to a special drafting group with the mandate to formulate an acceptable compromise proposal.

119. The representatives of Brazil, the German Democratic Republic, Nigeria, Singapore, Sweden, the Union of Soviet Socialist Republics, and the United States of America were appointed to the Special Drafting Group.

120. The Committee also requested the Special Drafting Group to consider the proposals relating to article 10 (2) which required declarations of avoidance to be in writing or to be followed by written notification.

Compromise proposals

121. The Committee considered three compromise proposals.

122. It was proposed that the following be added to the existing text of article 11:

"However, when so required by the legislation of any of the States in which the places of business of the parties are situated, a contract must be concluded in written form, failing which it shall [be null and void] [produce the consequences provided for under such legislation].

'Written form' or 'writing' includes communications by telegraph and teleprinter."

123. In support of this proposal, it was stated that it constituted a compromise in that it permitted the retention of article 11 although, in the view of several representatives, article 11 dealt with matters of formation and validity of contracts which were outside the proper scope of the Convention. However, in order to achieve a proper balance in the text it would be necessary to make an exception for cases where the legislation of any of the States in which the places of business of the parties are situated require that a contract must be concluded in "written form" which was defined to include communications by telegraph and teleprinter as well as those in handwritten or typed form.

124. However, under another view the proposal did not constitute an effective compromise because the substantive rules in article 11 would be set aside if contrary to the legislation in any of the States in which the places of business of the parties are situated even where, if the compromise proposal was not adopted, such legislation would not regulate the contract. In this respect it was stated that the proposal was less of a compromise than the original proposal to delete article 11.

125. The Committee, after deliberation, referred the proposal to the Special Drafting Group.

126. It was also proposed that the following paragraph be added to article 11:

"(2) The provisions of paragraph (1) do not affect an otherwise valid restriction on the authority of a party to conclude a contract other than in a prescribed form or manner if that restriction is prescribed by statutory law of the State where the party has its place of business and is either known to the other party or is widely known and regularly observed by parties to contracts of the type involved."

127. In support of this proposal it was stated that the proposed provision went a considerable distance in recognizing the needs of countries which required written form. However, it was noted that the article would introduce principles of national law into the Convention which might cause inconvenience to businessmen.

128. This proposal was also referred to the Special Drafting Group.

129. A number of representatives and observers were of the view that article 11 should be retained but that it should be made subject to reservations or declarations. It was stated that this would enable parties to know whether they must comply with national requirements relating to the form of the contract. This suggestion was also referred to the Special Drafting Group.

130. The Special Drafting Group proposed the following text:

"Article 11

"1. A contract of sale need not be evidenced by writing and is not subject to other requirements as to form. It may be proved by means of witnesses.

"2. Paragraph 1 of this article does not apply to a contract of sale where any party has its place of business in a Contracting State which has made a declaration under article (X) of this Convention.

"Article (X)

"A Contracting State under whose legislation a contract of sale shall be concluded in or evidenced by writing may, at the time of signature, ratification or accession, make a declaration to the effect that article 11, paragraph 1, shall not apply to any sale involving a party having its place of business in a State which has made such a declaration."

131. The Committee adopted a proposal that article 11 (1) should conform to article (X) by providing that a contract of sale need not be concluded in writing as well as that it need not be evidenced by writing. Several representatives opposed this proposal because it appeared to imply that the draft Convention was regulating matters concerning the formation of contracts rather than confining itself to contracts which were considered valid by the applicable law. These representatives considered that the proposal was appropriate for a Convention on Formation but not appropriate for a Convention on Sales.

132. The Committee rejected a proposal that article 11 (1) be divided into two articles, one dealing with the form of contracts and the other dealing with questions of proof.

133. A representative stated that the definition of "place of business" in article 6 (a) would create difficulties in practice in relation to the application of article 11 and article (X). The same representative also indicated that article (X) was based on a system of reciprocity since article 11 (1) would only be excluded if both Contracting States had made declarations under article (X). In his view, a declaration by one Contracting State should be sufficient to exclude the operation of article 11 (1).

Decision

134. The Committee therefore recommends that the Commission should adopt the following text:

"Article 11

"(1) A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirements as to form. It may be proved by any means including witnesses.

"(2) Paragraph (1) of this article does not apply to a contract of sale where any party has his place of business in a Contracting State which has made a declaration under article (X) of this Convention.*

"* *Article (X)*

"A Contracting State whose legislation requires a contract of sale to be concluded in or evidenced by writing may, at the time of signature, ratification or accession, make a declaration to the effect that article 11, paragraph (1), shall not apply to any sale involving a party having his place of business in a State which has made such a declaration."

ARTICLE 12

135. The text of article 12, as adopted by the Working Group on the International Sale of Goods is as follows:

"If, in accordance with the provisions of this Convention, one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgement providing for specific performance unless this could be required by the court under its own law in respect of similar contracts of sale not governed by this Convention."

136. The Committee concludes that no change of substance is called for in respect of article 12. It therefore recommends that the Commission should adopt the following text:

"Article 12

"If, in accordance with the provisions of this Convention, one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgement for specific performance unless the court could do so under its own law in respect of similar contracts of sale not governed by this Convention."

ARTICLE 13

137. The text of article 13, as approved by the Working Group on the International Sale of Goods, is as follows:

"In the interpretation and application of the provisions of this Convention, regard is to be had to its international character and to the need to promote uniformity."

138. The Committee considered several proposals seeking to specify more clearly the criteria of interpretation. These proposals were based on the premise that the proposed wording of article 13 was too general and lacked substance.

Intention of the parties as basis for interpretation

139. It was noted that article 13 was concerned with the interpretation and application of the provisions of the Convention and that the Convention did not contain a provision on the interpretation of the contract. The proposal was made that article 13 be preceded by a provision stating that "in the interpretation of contracts regard is to be had to the purpose of the contract and the interdependence of its various provisions". It was submitted that a rule governing interpretation of a contract of sale was needed in order to enable the courts to establish the respective rights and obligations of the parties as specified in the contract and contemplated by the parties.

140. Because it lacked sufficient support, the proposal was not retained. It was pointed out that the proposal enunciated a universally accepted principle of interpretation which had no place in the Convention and that the Working Group on the International Sale of Goods was engaged in preparing a draft text on the validity of a contract of sale, a matter which extended to some issues relating to interpretation of contracts of sale of goods.

Private international law

141. Another proposal considered by the Committee was worded as follows:

"With regard to matters pertaining to the relations between the parties to a contract of sale which are not covered by this Convention, the substantive rules of the State where the seller has his place of business shall apply."

142. In support of this proposal, the view was expressed that the Commission, in addition to unifying substantive law, should also endeavour to unify the rules of conflict of laws which affect the contract of sale. A rule on the lines of the proposed text would be a step in that direction. Moreover, the proposed provision was in harmony with article 3 of the 1955 Hague Convention on the Law Applicable to International Sale of Goods.* If parties should find such a rule too rigid they could derogate from it under article 5 of the Sales Convention.

143. The Committee, after deliberation, did not retain the

* The 1955 Hague Convention on the Law Applicable to International Sale of Goods appears in the *Register of Texts of Conventions and other Instruments Concerning International Trade Law*, vol. I (United Nations publication, Sales No: E.71.V.3), chap. I, sect. I.

proposal. The view was expressed that a rule of private international law had no place in an international convention providing substantive rules to regulate the relationship of buyer and seller, such as the one under consideration. Whilst it was true that article 3 of the 1955 Hague Convention opted for the law of the country where the seller had his place of business, that article listed exceptions. Thus, a contract of sale concluded in the country of the buyer, as the result of an attempt on the part of the seller to attract customers, would come under the 1955 Hague Convention. The point was also made that, unless a reservation clause were included in the final clauses of the Convention, the proposal, if adopted, would give rise to problems for those States which were parties to the 1955 Hague Convention.

General principles on which the Convention is based

144. A third proposal was as follows:

"In the interpretation and application of the provisions of this Convention regard is to be had to the general principles on which this Convention is based, to its international character and to the need to promote uniformity."

145. The proposal was made on the ground that the guidelines offered by article 13 were insufficient and that it would be desirable to refer expressly to the general principles on which the Convention is based. It was of great importance that, in case of doubt as to the interpretation of certain provisions of the Convention, the Courts should not refer to domestic law.

146. The Committee did not retain this proposal since it did not receive sufficient support.

Decision

147. The Committee concludes that no change of substance is called for in respect of article 13. It therefore recommends that the Commission should adopt the following text:

"Article 13

"In the interpretation and application of the provisions of this Convention, regard is to be had to its international character and to the need to promote uniformity."

Chapter III. Obligations of the seller

ARTICLE 14

148. The text of article 14, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The seller must deliver the goods, hand over any documents relating thereto and transfer the property in the goods, as required by the contract and this Convention."

149. The Committee concludes that no change in substance is called for in respect of article 14. It therefore recommends that the Commission should adopt the following text:

"Article 14

"The seller must deliver the goods, hand over any documents relating thereto and transfer the property in the goods, as required by the contract and this Convention."

Section I. Delivery of the goods and handing over of documents

ARTICLE 15

150. The text of article 15 as adopted by the Working Group on the International Sale of Goods, is as follows:

"If the seller is not required to deliver the goods at a particular place, delivery is made:

"(*a*) If the contract of sale involves carriage of the goods, by handing the goods over to the first carrier for transmission to the buyer;

"(*b*) If, in cases not within the preceding paragraph, the contract relates to

"(i) Specific goods, or

"(ii) Unidentified goods to be drawn from a specific stock or to be manufactured or produced,

and at the time of the conclusion of the contract the parties knew that the goods were at, or were to be manufactured or produced at, a particular place, by placing the goods at the buyer's disposal at that place;

"(*c*) In other cases by placing the goods at the buyer's disposal at the place where the seller had his place of business at the time of the conclusion of the contract."

Introductory phrase

151. The Committee did not retain a proposal that the words "or in accordance with a particular trade term" be added to the opening phrase of article 15 so that it would read:

"If the seller is not required to deliver the goods at a particular place or in accordance with a particular trade term, delivery is made:"

This proposal was considered to be unnecessary since the seller's obligation to deliver arose out of the contract, which would include any trade term used in the contract.

152. The Committee considered and adopted, subject to review by the Drafting Group, a proposal that the opening phrase of article 15 read:

"Where no other place for delivery is fixed or determinable by agreement or usage, delivery is made:"

The new language was intended to make it clear that the rules in article 15 would apply only if the contract did not specify that the seller was bound to deliver the goods at any other particular place.

"Usages"

153. The Committee agreed that the "usages" referred to in the proposed text as well as in article 17, referred to usages as defined under article 8. It left to the Drafting Group to consider whether it was opportune to refer to "usages" or whether, in the light of article 8, it was unnecessary to do so.

Paragraph (a)

154. The Committee rejected a proposal to add the words "or to the shipper" after the phrase "handing the goods over to the first carrier". These words were considered unnecessary since whoever took the goods for shipment was the "first carrier" for the purposes of the Convention.

Decision

155. The Committee concludes that no change of substance is called for in respect of article 15. It therefore recommends that the Commission should adopt the following text:

"Article 15

"If the seller is not bound to deliver the goods at any other particular place, his obligation to deliver consists:

"(*a*) If the contract of sale involves carriage of the goods —in handing the goods over to the first carrier for transmission to the buyer;

"(*b*) If, in cases not within the preceding subparagraph, the contract relates to specific goods, or unidentified goods to be drawn from a specific stock or to be manufactured or produced, and at the time of the conclusion of the contract the parties knew that the goods were at, or were to be manufactured or produced at, a particular place—in placing the goods at the buyer's disposal at that place;

"(*c*) In other cases—in placing the goods at the buyer's disposal at the place where the seller had his place of business at the time of the conclusion of the contract."

ARTICLE 16

156. The text of article 16 as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) If the seller is required to hand the goods over to a carrier and if the goods are not clearly marked with an address or are not otherwise identified to the contract, the seller must send the buyer a notice of the consignment which specifies the goods.

"(2) If the seller is required to arrange for carriage of the goods, he must make such contracts as are necessary for the carriage to the place fixed by means of transportation which are appropriate in the circumstances and according to the usual terms for such transportation.

"(3) If the seller is not required to effect insurance in respect of the carriage of the goods, the seller must provide the buyer, at his request, with all available information necessary to enable him to effect such insurance."

157. The Committee considered but did not retain a proposal for an exception to the general rule in article 10 as adopted by the Committee which provides that a party who has sent a notice by appropriate means may rely on the notice even if it does not arrive. Under the proposal the seller could have relied on a notice sent under article 16 (1) only if the notice arrived.

Decision

158. The Committee concludes that no change of substance is called for in respect of article 16. It therefore recommends that the Commission should adopt the following text:

"Article 16

"(1) If the seller is bound to hand the goods over to a carrier and if the goods are not clearly marked with an address or are not otherwise identified to the contract, the seller must send the buyer a notice of the consignment which specifies the goods.

"(2) If the seller is bound to arrange for carriage of the goods, he must make such contracts as are necessary for the carriage to the place fixed by means of transportation which are appropriate in the circumstances and according to the usual terms for such transportation.

"(3) If the seller is not bound to effect insurance in respect of the carriage of the goods, he must provide the buyer, at his request, with all available information necessary to enable him to effect such insurance."

ARTICLE 17

159. The text of article 17, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The seller must deliver the goods:

"(*a*) If a date is fixed or determinable by agreement or usage, on that date; or

"(*b*) If a period (such as a stated month or season) is fixed or determinable by agreement or usage, at any time within that period unless circumstances indicate that the buyer is to choose a date; or

"(*c*) In any other case, within a reasonable time after the conclusion of the contract."

160. The Committee considered but did not retain the following proposals:

(i) That the reference to usages be deleted from paragraph (*a*);

(ii) That the word "circumstances" in paragraph (*b*) be made more precise;

(iii) That the phrase "within a reasonable time" in paragraph (*c*) be made more precise by adding the words "taking into account the nature of the goods and the circumstances of the contract";

(iv) That a new paragraph (2) be added which would require the seller to give the buyer notice of the date for delivery reasonably in advance of delivery where that date is fixed by the seller.

Decision

161. The Committee concludes that no change of substance is called for in respect of article 17. It therefore recommends that the Commission should adopt the following text:

"Article 17

"The seller must deliver the goods:

"(*a*) If a date is fixed by or determinable from the contract, on that date; or

"(*b*) If a period of time is fixed by or determinable from the contract, at any time within that period unless circumstances indicate that the buyer is to choose a date; or

"(*c*) In any other case, within a reasonable time after the conclusion of the contract."

ARTICLE 18

162. The text of article 18, as adopted by the Working Group on the International Sale of Goods, is as follows:

"If the seller is required to hand over documents relating to the goods, he must hand them over at the time and place and in the form required by the contract."

163. The Committee concludes that no change of substance is called for in respect of article 18. It therefore recommends that the Commission adopt the following text:

"Article 18

"If the seller is bound to hand over documents relating to the goods, he must hand them over at the time and place and in the form required by the contract."

PROPOSED ARTICLE 18 BIS

164. The Committee considered a proposal to add the following article as article 18 *bis:*

"The buyer loses the right to rely on any late performance by the seller if he does not give the seller notice thereof within a reasonable time after performance was rendered."

165. In support of this proposal, it was stated that the article would parallel the requirement in article 23 of the giving of a notice specifying the nature of any lack of conformity of the goods. However, the Committee did not retain the proposal as it was generally considered that the buyer should not lose his remedies for late performance by the seller simply because he had failed to give notice.

Section II. Conformity of the Goods

ARTICLE 19

166. The text of article 19 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) The seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract. Except where otherwise agreed, the goods do not conform with the contract unless they:

"(*a*) Are fit for the purposes for which goods of the same description would ordinarily be used;

"(*b*) Are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgement;

"(*c*) Possess the qualities of goods which the seller has held out to the buyer as a sample or model;

"(*d*) Are contained or packaged in the manner usual for such goods.

"(2) The seller is not liable under subparagraphs (*a*) to (*d*) of paragraph (1) of this article for any non-conformity of the goods if at the time of the conclusion of the contract the buyer knew or could not have been unaware of such non-conformity."

Subparagraph (1) (b)

167. The Committee considered a proposal that this subparagraph apply only to those particular purposes which are expressly made known to the seller and that the exception to the seller's responsibility contained in the latter part of the subparagraph be deleted. The proposal would thus amend the subparagraph to read as follows:

"(*b*) Are fit for any particular purpose expressly made known to the seller at the time of the conclusion of the contract;"

The two aspects of this proposal are considered separately.

(i) *Limitation of subparagraph to those particular purposes expressly made known to the seller*

168. In support of the proposal to delete reference to particular purposes impliedly made known to the seller, it was stated that the present text of article 19 (1) (*b*) imposes the difficult task on a tribunal of determining whether the seller had the requisite implied knowledge. However, the Committee did not retain this proposal as it found little support.

(ii) *Deletion of exceptions to the seller's responsibility*

169. Under this aspect of the proposal the words "except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgement" would have been deleted from article 19 (1) (*b*). In support of this proposal, it was stated that it would avoid complicated litigation in which the seller sought to establish that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgement. It was noted that the proposal also had the advantage of greatly simplifying the language of article 19 (1) (*b*). In addition, the proposed text would ensure that the seller must supply goods which conform to the contract. It was pointed out that should the seller consider that the goods may not be fit for the particular purposes stated by the buyer, the seller should decline to enter into the contract. It was also suggested that article 19 (1) (*b*) may be superfluous because the seller would be responsible under the first sentence of article 19 (1) for any failure of the goods to be fit for any purposes expressly or impliedly made part of the contract. Article 19 (1) (*b*) simply contained a rule of interpretation which may aid a court to decide whether those particular purposes were part of the contract. As this result would follow under most national rules of interpretation, it would do little harm to delete this portion of article 19 (1) (*b*) which was couched in language which caused considerable difficulty.

170. In opposition to the proposal to delete the second part of the subparagraph, it was stated that it was equitable for the seller to escape responsibility where it demonstrated that a buyer did not rely upon the seller's skill and judgement or where the special expertise of the buyer made it unreasonable for him to claim reliance on the general expertise of the seller. It was also stated that since all the subparagraphs of article 19 (1) were prefaced by the expression "except where otherwise agreed" it followed that if the last part of article 19 (1) (*b*) were deleted, the rules of interpretation in many jurisdictions may entail the result that the seller would be liable for any failure of the goods to be fit for a particular purpose made known to the seller whether or not that particular purpose was made part of the contract. It was pointed out that the existing text created an equitable balance between seller and buyer. Furthermore, under article 19 (1) (*a*) the seller would, unless otherwise agreed, always be responsible for goods which were not fit for the purposes for which goods of the same description would ordinarily be used.

171. After considerable discussion and deliberation, the Committee did not retain the proposal.

Other proposals relating to subparagraph (1) (b)

172. The Committee also considered a proposal that article 19 (1) (*b*) be replaced by the following:

"(*b*) Are fit for any particular purpose [expressly or impliedly] made part of the contract;".

173. In support of this proposal, it was stated that the buyer should be able to rely upon the goods not being suitable for a particular purpose only if that particular purpose was made part of the contract. A further advantage of this proposal was stated to be that it avoided the complications of the second part of the present text of article 19 (1) (*b*). However, it was pointed out that limiting the provision to particular purposes which were made part of the contract was an unjustified narrowing of the seller's obligations and that accordingly it was desirable to retain the original text.

174. After considerable discussion the Committee did not retain this proposal.

175. The Committee also considered, during its deliberations on the major proposals discussed above, the following proposals which were designed to overcome some of the difficulties expressed in relation to article 19 (1) (*b*):

(i) That article 19 (1) (*b*) be deleted because of the difficulties that it had generated;

(ii) That the exception in article 19 (1) (*b*) only operate in cases where the particular purposes were impliedly made known to the seller but not where the particular purposes were expressly made known to him;

(iii) That the words "or that it was unreasonable for him to rely" be deleted from article 19 (1) (*b*);

(iv) That the words "expressly or impliedly made known to the seller" be replaced by "expressly or impliedly specified to the seller".

176. None of these proposals commanded sufficient support in the Committee and were not retained.

Burden of proof

177. The Committee considered a proposal that the following paragraph be added to article 19:

"(3) The seller has to prove that the goods delivered by him conform to the contract. However, if the buyer wants to rely on a lack of conformity which he discovered after the expiration of the period within which he had to examine the goods under article 22, the buyer has to prove this lack of conformity. The buyer is considered to have discovered the lack of conformity before the expiration of this period if he has given the seller notice of the lack of conformity within a reasonable time after the expiration of this period."

178. There was little support for this proposal as it was considered inappropriate for the Convention, which relates to the international sale of goods, to deal with matters of evidence or procedure. The Committee, accordingly did not retain the proposal.

Contracts where buyer supplies a small part of the materials

179. The Committee considered a proposal to introduce a rule into article 19 to deal with the situation where the goods do not conform with the contract because of a defect in materials supplied by the buyer. It was pointed out that article 3 (2) did not exclude such cases from the scope of application of the Convention where the amount of material supplied by the buyer was less than a substantial part of the materials necessary for the manufacture and production of the goods. The Committee also considered a proposal that article 3 (2) be amended to deal with this problem to achieve essentially the same result.

180. These proposals, in their final form, were as follows:

(i) That the following paragraph be added to article 19:

"(3) The seller is not liable under paragraph (1) of this article for lack of conformity caused by defects in material supplied by the buyer for use in manufacture or production of the goods:

"(*a*) Unless the seller knew, or could not have been unaware, of such defects;

"(*b*) The same provision applies if the buyer insisted on using such material even after having been notified of its defects."

(ii) That the underscored words be added to article 3 (2):

"(2) Contracts for the supply of goods to be manufactured or produced are to be considered sales unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production. *If the buyer undertakes to supply less than a substantial part of those materials, this Convention applies to that supply as it would to a sale unless the circumstances indicate the contrary.*"

181. In support of the first proposal it was pointed out that even though the amount of material supplied by the buyer was not substantial, a defect in these materials might cause a major lack of conformity in the goods as produced by the seller. It was stated that the seller should be liable for any lack of conformity of goods produced by him caused by defects in materials supplied by the buyer but that this obligation should not be absolute. The seller should not be liable if the seller did not know or could not have been aware of such defects or if the buyer insisted on the use of those materials after notification of the defects in the materials supplied.

182. Under another view, the proposal was unnecessary since it dealt with a matter of minor importance and merely stated an obvious result.

183. The second proposal, which sought to achieve the same result by amending article 3 (2), was met by the same criticisms that were directed against the first proposal. In addition, it was stated that the notion that the Convention applied to the supply of materials by the buyer to the seller "as it would to a sale unless the circumstances indicate the contrary" could raise difficulties of interpretation since the buyer would have to be treated as the seller and vice versa. Further, such a fictional contract, without a price, would cause difficulties in a number of legal systems.

184. Although there was considerable support for the general principle contained in these proposals the Committee, after extensive discussion centred on eliminating drafting difficulties, decided to reject both proposals.

Decision

185. The Committee concludes that no change of substance is called for in respect of article 19. It therefore recommends that the Commission should adopt the following text:

"Article 19

"(1) The seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract. Except where otherwise agreed, the goods do not conform with the contract unless they:

"(*a*) Are fit for the purposes for which goods of the same description would ordinarily be used;

"(*b*) Are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgement;

"(*c*) Possess the qualities of goods which the seller has held out to the buyer as a sample or model;

"(*d*) Are contained or packaged in the manner usual for such goods.

"(2) The seller is not liable under subparagraphs (*a*) to (*d*) of paragraph (1) of this article for any non-conformity of the goods if at the time of the conclusion of the contract the buyer knew or could not have been unaware of such non-conformity."

ARTICLE 20

186. The text of article 20 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) The seller is liable in accordance with the contract and this Convention for any lack of conformity which exists at the time when the risk passes to the buyer, even though the lack of conformity becomes apparent only after that time.

"(2) The seller is also liable for any lack of conformity which occurs after the time indicated in paragraph (1) of this article and which is due to a breach of any of his obligations, including a breach of any express guarantee that the goods will remain fit for their ordinary purpose or for some particular purpose, or that they will retain specified qualities or characteristics for a specific period."

Decision

187. The Committee concludes that no change of substance is called for in respect of article 20. It therefore recommends that the Commission should adopt the following text:

"Article 20

"(1) The seller is liable in accordance with the contract and this Convention for any lack of conformity which exists at the time when the risk passes to the buyer, even though the lack of conformity becomes apparent only after that time.

"(2) The seller is also liable for any lack of conformity which occurs after the time indicated in paragraph (1) of this article and which is due to a breach of any of his obligations, including a breach of any express guarantee that the goods will remain fit for their ordinary purpose or for some particular purpose, or that they will retain specified qualities or characteristics for a specific period."

ARTICLE 21

188. The text of article 21 as adopted by the Working Group on the International Sale of Goods is as follows:

"If the seller has delivered goods before the date for delivery, up to that date he may deliver any missing part or quantity of the goods or deliver other conforming goods or cure any lack of conformity in the goods delivered, provided that the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense. However, the buyer retains any right to claim damages as provided in article 55."

189. The Commission considered, but did not retain, a proposal that article 21 expressly state that the seller has a right to deliver the goods before the date of delivery in order to make explicit what is already implicit in the language of article 21. However, there was little support for this proposal as it was considered that the emphasis in article 21 should remain on the seller's right to cure and that it would be inappropriate to confer on a party to a contract the right to breach that contract.

Decision

190. The Committee concludes that no change of substance is called for in respect of article 21. It therefore recommends that the Commission should adopt the following text:

"Article 21

"If the seller has delivered goods before the date for delivery, he may, up to that date, deliver any missing part or make up any deficiency in the quantity of the goods delivered, or deliver goods in replacement of any non-conforming goods delivered or remedy any lack of con-

formity in the goods delivered, provided that the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense. The buyer retains any right to claim damages as provided for in this Convention."

ARTICLE 22

191. The text of article 22 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) The buyer must examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances.

"(2) If the contract involves carriage of the goods, examination may be deferred until after the goods have arrived at the place of destination.

"(3) If the goods are redispatched by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redispatch, examination may be deferred until after the goods have arrived at the new destination."

Paragraph (1)

192. The Committee considered a proposal to replace paragraph (1) with the following provision:

"(1) Where the goods are delivered to the buyer, he is not deemed to have accepted them unless and until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract."

193. In support of this proposal, it was stated that the buyer should have a right to examine the goods and that accordingly acceptance should be postponed until the buyer had such an opportunity for examination. However, it was pointed out that the framing of the proposal in terms of acceptance rather than in terms of an obligation to examine the goods would cause needless difficulties since national law doctrines relating to acceptance differed widely. In any case, the buyer was adequately protected by article 23 (1) which provides that the right to rely on a lack of conformity is lost only if the buyer does not give notice "within a reasonable time after he has discovered it or ought to have discovered it".

194. The Committee, after deliberation, decided not to retain this proposal.

Paragraph (2)

195. The Committee considered a proposal that in cases involving carriage of goods the examination may be deferred until the goods arrive at the final place of destination. The Committee did not retain this proposal as it commanded no support.

Decision

196. The Committee concludes that no change in substance is called for in respect of article 22. It therefore recommends the following text to the Commission:

"Article 22

"(1) The buyer must examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances.

"(2) If the contract involves carriage of the goods, examination may be deferred until after the goods have arrived at their destination.

"(3) If the goods are redispatched by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redispatch, examination may be deferred until after the goods have arrived at the new destination."

ARTICLE 23

197. The text of article 23, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) The buyer loses the right to rely on a lack of conformity of the goods if he does not give the seller a notice specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.

"(2) In any event, the buyer loses the right to rely on a lack of conformity of the goods if he does not give the seller notice thereof at the latest within a period of two years from the date on which the goods were actually handed over to the buyer, unless such time-limit is inconsistent with a contractual period of guarantee."

Paragraph (1)

198. The Committee considered a proposal that the text should be reworded to indicate that the buyer does not lose his "right" to rely on a lack of conformity in the goods if he fails to give notice but that he loses the power to enforce his rights. This would furnish a better legal basis for the common occurrence that, without being obligated to do so, the seller recognizes his obligations in respect of his having delivered goods which failed to conform to the contract, in spite of not having received notice of the lack of conformity in proper time.

199. The Committee did not retain this proposal for lack of support.

200. The Committee considered two proposals to reduce the obligation of the buyer to examine the goods. The first proposal was for the replacement of the words "ought to have discovered [the lack of conformity]" by "could have discovered it in the circumstances". The second proposal would have deleted the words "within a reasonable time". It was suggested that the buyer should be placed under no obligation to discover defects. In particular, buyers from developing countries are at a particular disadvantage when it comes to examining technologically complicated machinery.

201. The Committee did not retain these proposals since it was of the view that the buyer should have the duty both to examine the goods and to notify the seller of lack of conformity. However, the Committee referred to the Drafting Group the question as to whether the words "in the circumstances" should be added to the words "or ought to have discovered it".

Recommendation of the Drafting Group[1]

202. The Drafting Group, however, queried whether the expression "in the circumstances" should be included in paragraph (1) of article 23 because, although the length of the period clearly depended on the circumstances of the case, the insertion of this expression in only one article could lead to a contrary conclusion in other articles of the Convention which did not use this expression in relation to other time-limits imposed on the parties. The Drafting Group accordingly placed the expression "in the circumstances" within square brackets. The Committee accepted the recommendation of the Drafting Group and deleted the expression from the article.

Paragraph (2)

203. The Committee considered a proposal to shorten the maximum period during which notice can be given from two years to one year. A two-year period was said to be longer than that which is found in most national legislation and to be an excessively long period for a seller not to know whether a claim for lack of conformity of the goods would be made by the buyer.

204. On the other hand it was said that it would work to the disadvantage of the developing countries if the maximum period of time for giving notice were to be shortened. The Committee decided not to retain this proposal.

205. The Committee also considered various proposals to

[1] See para. 9 above.

have the point of time at which the two-year time-limit commences more clearly associated with the point of time at which the buyer is required to examine the goods under article 22, and especially where examination of the goods may be deferred because of redispatch. It was noted that under article 22 the buyer is required to examine the goods within as short a period as is practicable in the circumstances, which, in the case where the contract involves the carriage of goods, is after the goods have arrived at their place of destination. It was also noted that where the goods are redispatched by the buyer without a reasonable opportunity for examination by him, in certain circumstances the examination may be deferred until after the goods have arrived at the new destination. However, under article 23 (2) the two-year time-limit for giving notice of lack of conformity commenced on the date the goods "were actually handed over to the buyer".

206. However, it was pointed out that a period of fixed length, such as the two-year maximum period for giving notice under article 23 (2), should commence on an easily ascertainable date. The most easily ascertainable date is the date on which the goods were actually handed over to the buyer. Even if that date may be as much as several months prior to the date on which examination of the goods is practicable or required under article 22 (3) in those cases in which the goods have been redispatched, it is not an unreasonable point of time from which to measure the maximum period for giving notice in view of the fact that two years is a relatively long time for giving such notice. It was also noted that the time the goods were actually handed over to the buyer was the point of time at which the four-year period of limitation commences under the Convention on the Limitation Period. As a result the Committee did not retain this proposal.

Decision

207. The Committee concludes that no change of substance is called for in respect of article 23. It therefore recommends that the Commission should adopt the following text:

"Article 23

"(1) The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.

"(2) In any event, the buyer loses the right to rely on a lack of conformity of the goods if he does not give the seller notice thereof at the latest within a period of two years from the date on which the goods were actually handed over to the buyer, unless such time-limit is inconsistent with a contractual period of guarantee."

ARTICLE 24

208. The text of article 24, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The seller is not entitled to rely on the provisions of articles 22 and 23 if the lack of conformity relates to facts of which he knew or could not have been unaware and which he did not disclose to the buyer."

Decision

209. The Committee concludes that no change of substance is called for in respect of article 24. It therefore recommends that the Commission should adopt the following text:

"Article 24

"The seller is not entitled to rely on the provisions of articles 22 and 23 if the lack of conformity relates to facts of which he knew or could not have been unaware and which he did not disclose to the buyer."

ARTICLE 25

210. The text of article 25, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The seller must deliver goods which are free from the right or claim of a third person, unless the buyer agreed to take the goods subject to such right or claim."

211. The Committee established a Special Working Group consisting of the representatives of Finland, German Democratic Republic, Ghana, India, Japan and Mexico to prepare a revised article 25 to cover situations in which the goods sold were subject to a right or claim of a third party based on industrial or intellectual property.

212. The text of article 25, as proposed by the Special Working Group, is as follows:

"(1) The seller must deliver goods which are free from the right or claim of a third party, other than one based on industrial or intellectual property, unless the buyer agreed to take the goods subject to that right or claim.

"(2) The seller must deliver goods which are free from any right or claim of a third party, of which at the time of the conclusion of the contract the seller knew or could not have been unaware, if that right or claim is based on industrial or intellectual property:

"(*a*) Under the law of the State where the goods will be used if it was contemplated by the parties at the time of the conclusion of the contract that the goods will be used in that State; or

"(*b*) In any case under the law of the State where the buyer has his place of business.

"(3) The obligation of the seller under paragraph (2) of this article does not extend to cases where:

"(*a*) At the time of the conclusion of the contract the buyer knew or could not have been unaware of the right or claim; or

"(*b*) The right or claim results from the seller's compliance with technical drawings, designs, formulae or other such specifications furnished by the buyer.

"(4) Failure by the buyer to give notice of the right or claim has the same consequences as failure to give notice of lack of conformity under article 23."

Paragraph (1)

213. The Committee noted that paragraph (1) reproduced in principle the text of article 25 as adopted by the Working Group on the International Sale of Goods with the exception that claims based on industrial or intellectual property were expressly excluded as they were to be dealt with in articles 25 (2) to 25 (4).

214. The Committee adopted paragraph (1).

Paragraph (2)

215. The Committee noted that the Special Working Group had two major objectives in formulating paragraph (2). The first was to define the limits of the seller's responsibility to supply goods which were free from any right or claim of a third party based on industrial or intellectual property. The objective was achieved by making the seller responsible for those rights or claims of which, at the time of the conclusion of the contract, he knew or could not have been unaware. The second objective was to indicate which industrial or intellectual property laws were relevant in determining whether the seller had breached his obligation to supply goods free from the industrial or intellectual property rights or claims of a third party. This was achieved by selecting the law of the State where the goods would be used, if use in that State was contemplated by the parties at the time of the conclusion of the contract or, in any other case, under the law where the buyer had his place of business.

216. Although there was general support for the text proposed by the Special Working Group, two representatives reserved their position in relation to this paragraph and to

paragraphs (3) and (4). One representative indicated that he was not prepared to discuss the substantive rules contained in articles 25 (2) to 25 (4) because the regulation of industrial or intellectual property rights was too complex a matter to be resolved in the context of a draft Convention on the International Sale of Goods. Another representative stated that industrial or intellectual property rights should be regulated in a separate instrument and not in a draft Sales Convention.

217. An observer, while not objecting to the fact that industrial or intellectual property rights were dealt with in the Convention, objected to the substance of the rules contained in paragraphs (2) to (4) since, in his view, they would encourage the breach of existing international Conventions which regulated industrial or intellectual property rights.

218. The Committee adopted a proposal to make it clear that the seller had breached his obligation if, because of the right or claim of the third party, the buyer was precluded from reselling the goods as well as if he was precluded from using them.

219. The Committee considered, but did not retain, the following proposals to amend article 25 (2):

(i) That subparagraphs (*a*) and (*b*) be cumulative rather than alternative in order to give added protection to persons who had bought goods subject to claims based on industrial or intellectual property;

(ii) That the expression "industrial or intellectual property" be replaced by "intellectual property" to accord with modern commercial usage. The Committee retained the expression "industrial or intellectual property" to ensure that the scope of the provision was not misunderstood.

Limits to paragraph (2)

220. It was noted that the Special Working Group did not deal with the question of breaches of administrative regulations which might restrict the use or sale of goods and consequently, this matter was to be regulated by national law.

Paragraph (3)

221. The Commission noted that the objective of the Special Working Group in relation to paragraph (3) was to state limits to the responsibility of the seller in terms of the knowledge of the buyer. The general notion was that the seller would not be liable under paragraph (2) if the buyer knew or could not have been unaware at the time of the conclusion of the contract of the existence of those rights or claims or where the right or claim resulted from the seller's compliance with technical drawings, designs, formulae or other such specifications furnished by the buyer.

Paragraph (4)

222. The Committee noted that the objective of the Special Working Group in relation to paragraph (4) was to regulate the consequences of failure by the buyer to give notice of a right or claim of a third party based on industrial or intellectual property.

223. There was considerable discussion on whether both paragraphs (1) and (2) of article 23 should apply to a right or claim based on industrial or intellectual property. It was generally considered that the two-year period during which notice had to be given in accordance with article 23 (2) was inappropriate in relation to article 25 (4).

224. The Committee, in order to clarify the situation, decided to incorporate as nearly as possible the text of the notice requirements of article 23 (1) into article 25 (4).

Structure of article 25

225. The Committee decided to separate the proposed article 25 into two provisions. Article 25 (1) would become a separate article, numbered article 25, referring to third party rights or claims other than those based on industrial or intellectual property. Paragraphs (2) to (4) of article 25 would be contained in a separate article (article 26) dealing with industrial or intellectual property claims. The Committee also decided to broaden the title of section II of chapter III of the Convention so that it would refer to claims of third persons.

Relationship to article 7

226. As a consequence of adopting article 26, the Committee deleted article 7 (2).

Recommendation of the Drafting Group[g]

227. The Drafting Group noted that, as a result of the action of the Committee in separating the proposed article 25 into two provisions, the notice requirement of the proposed article 25 (4) would no longer apply to the provision on third party rights or claims other than those based on industrial or intellectual property (now article 25). However, because it was not clear that this was a deliberately intended result of the Committee's action, the Drafting Group prepared a new paragraph (2) to article 25 on the consequences of the failure by the buyer to give notice of a right or claim of a third party. This new paragraph, which was identical to the notice requirement as proposed by the Drafting Group for article 26 (3) (the new numbering of the original proposed article 25 (4)), was placed in square brackets by the Drafting Group to bring to the attention of the Committee the question as to whether it should be retained.

228. The Committee decided to have such a provision and accordingly removed the square brackets. Two representatives indicated that they preferred to retain the square brackets as they were opposed to the substance of the provision.

Decision

229. The Committee, therefore, recommends that the Commission adopt the following text of articles 25 and 26:

"Article 25

"(1) The seller must deliver goods which are free from any right or claim of a third party, other than one based on industrial or intellectual property, unless the buyer agreed to take the goods subject to that right or claim.

"(2) The buyer does not have the right to rely on the provisions of this article if he does not give notice to the seller specifying the nature of the right or claim of the third party within a reasonable time after he became aware or ought to have become aware of the right or claim.

"Article 26

"(1) The seller must deliver goods which are free from any right or claim of a third party based on industrial or intellectual property, of which at the time of the conclusion of the contract the seller knew or could not have been unaware, provided that that right or claim is based on industrial or intellectual property:

"(*a*) Under the law of the State where the goods will be resold or otherwise used if it was contemplated by the parties at the time of the conclusion of the contract that the goods would be resold or otherwise used in that State; or

"(*b*) In any other case under the law of the State where the buyer has his place of business.

"(2) The obligation of the seller under paragraph (1) of this article does not extend to cases where:

"(*a*) At the time of the conclusion of the contract the buyer knew or could not have been unaware of the right or claim; or

"(*b*) The right or claim results from the seller's compliance with technical drawings, designs, formulae or other such specifications furnished by the buyer.

"(3) The buyer does not have the right to rely on the provisions of this article if he does not give notice to the seller specifying the nature of the right or claim of the third party within a reasonable time after he became aware or ought to have become aware of the right or claim."

[g] See para. 9 above.

ARTICLE 26

230. The text of article 26 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) If the seller fails to perform any of his obligations under the contract and this Convention, the buyer may:

"(*a*) Exercise the rights provided in articles 27 to 33;

"(*b*) Claim damages as provided in articles 55 to 59.

"(2) The buyer is not deprived of any right he may have to claim damages even though he resorts to other remedies.

"(3) If the buyer resorts to a remedy for breach of contract, the seller is not entitled to apply to a court or arbitral tribunal to grant him a period of grace."

Paragraph (1)

231. The Committee considered a suggestion that the enumeration of remedies in article 26 (1) did not make it clear whether the buyer could claim damages in addition to exercising the rights provided in articles 27 to 33. It was suggested that this problem might be overcome by placing appropriate connecting words between subparagraphs (*a*) and (*b*) of article 26 (1). Despite the preference of some representatives that the draft Convention not allow an accumulation of remedies, the generally accepted view was that the buyer should not be deprived of the right to claim for any damages he might have suffered by the mere fact that he had exercised other remedies. Even in cases where the buyer had declared the price reduced pursuant to article 31, he might have suffered additional damages, for instance because of delay. It was considered that the remedy scheme of the Convention should not preclude the buyer from obtaining such damages from the seller. It was pointed out that the Working Group on the International Sale of Goods had not placed the word "and" between subparagraphs (*a*) and (*b*) of article 26 (1) since accumulation of remedies may not be appropriate in all cases. It was also pointed out that the Working Group was of the opinion that this result could be more clearly obtained by the language of article 26 (2). However, the Committee considered that since the draft text might be misunderstood, it should be sent to the Drafting Group for possible clarification. The Drafting Group was also requested to consider whether any articles should be added or deleted from the enumeration of provisions contained in articles 26 (1) (*a*) and (*b*).

Paragraph (3)

232. The Committee considered a proposal that article 26 (3) be deleted. It was stated in support of this proposal that the object of the Convention should be to maintain the contract with the result that the seller should be permitted to apply to a court for a period of grace to perform the contract. In opposition to the proposal, it was stated that to allow a court to grant delay of grace would mean in some legal systems that a seller who performed within the additional time would not have breached the contract and could not, therefore, be liable for any damages for late delivery. As a result the Committee did not retain this proposal.

Exclusivity of remedies

233. The Committee considered a proposal that the Convention limit the rights of the buyer to those conferred on him by the Convention so that, except in cases of fraud, remedies based upon national law are excluded.

234. In support of this proposal it was stated that exclusion of national law remedies was desirable on grounds of uniformity since those remedies may permit a party to escape from the application of the sanctions in the draft Convention. On the other hand, the continued right to resort to national law remedies in cases of fraud would permit the continued application of the public policy of the State concerned.

235. In opposition to this proposal it was stated that even if the proposal were accepted, national rules which affected the formation and validity of the contract could still be applicable because these matters were excluded from the ambit of the draft Convention by article 7. The proposal contained the added risk that it may be interpreted in some legal systems to prevent the buyer from relying upon remedies stipulated in the contract despite the existence of article 5 which gave supremacy to the will of the parties. It was also pointed out that in situations where defective products had caused damage it may be inadvisable to protect the seller by preventing the buyer from relying on remedies in tort.

236. The Committee, after deliberation, did not retain the proposal.

Decision

237. The Committee concludes that no change of substance is called for in respect of this article, now renumbered as article 27. The Committee therefore recommends that the Commission should adopt the following text:

"Article 27

"(1) If the seller fails to perform any of his obligations under the contract and this Convention, the buyer may:

"(*a*) Exercise the rights provided in articles 28 to 34;

"(*b*) Claim damages as provided in articles 56 to 59.

"(2) The buyer is not deprived of any right he may have to claim damages by exercising his right to other remedies.

"(3) No period of grace may be granted to the seller by a court or arbitral tribunal when the buyer resorts to a remedy for breach of contract."

ARTICLE 27

238. The text of article 27 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) The buyer may require performance by the seller unless he has resorted to a remedy which is inconsistent with such requirement.

"(2) If the goods do not conform with the contract, the buyer may require delivery of substitute goods only if the lack of conformity constitutes a fundamental breach and a request for substitute goods is made either in conjunction with notice given under article 23 or within a reasonable time thereafter."

Paragraph (1)

(i) *Cover purchase*

239. The Committee considered a proposal that the buyer has no right to require performance if "it is reasonably possible for the buyer to purchase goods to replace those to which the contract relates". In support of this proposal, which adopted the approach of article 25 of ULIS, it was stated that if the buyer could easily purchase substitute goods it would be unreasonable to compel the seller to supply such goods when this may involve him in great expense. It was stated that the proposal was a particular application of the principle of mitigation of damages set forth in article 59 and accorded with commercial practice since rights to specific performance would usually be ineffective because of the delay in obtaining such relief from a court.

240. The contrary view was expressed that the proposal, if accepted, would unjustifiably restrict the rights of the buyer to require performance of the contract. The interests of the seller would be adequately protected under article 59 which imposed on the party who relies on a breach of contract the duty to mitigate the loss resulting from the breach. Furthermore, it was not equitable to compel the innocent party, i.e. the buyer, to go to the trouble of obtaining replacement goods. There was also the danger that the proposal, if adopted, might be abused by a seller anxious to avoid his contractual obligations. Finally, the proposal could complicate calculation of damages pursuant to article 56.

241. The Committee, after discussion, did not retain the proposal.

(ii) *Non-delivery*

242. The Committee also considered, but did not retain, a proposal that in case of non-delivery the buyer should be able to require the seller to deliver the goods only if he presents his request within a reasonable time after the last deadline for delivery.

Paragraphs (1) and (2)

Buyer's right to require repair

243. The Committee considered a number of proposals whose objective was to make it clear that article 27 authorized the buyer to demand that the seller remedy any defects in the goods.

244. There was general agreement that article 27 included the right of the buyer to require that defects in the goods be remedied but there was difference of opinion on whether this should be explicitly stated.

245. It was stated that some legal systems did not recognize the right to demand cure. Accordingly, if this result were to be achieved under the Convention, the right to demand cure should be made explicit in the text. However, under another view the present text of article 27 was clear and the complex changes proposed would only confuse the situation.

246. There was also difference of opinion on whether there should be any limitations on the exercise of the buyer's right to demand cure.

247. Under one view, the right to require cure should be limited to cases of fundamental breach and, if the goods had been delivered, the cure should not cause the seller unreasonable inconvenience or unreasonable expense. A prerequisite for the exercise of the right to demand cure should be that such demand be made in conjunction with the notice of conformity under article 23 or within a reasonable time thereafter. It was important to set out carefully the limits to the buyer's right to demand cure because national rules on specific performance differed widely. It was also noted that these limitations should be broadly similar to those governing the right to demand substitute goods pursuant to article 27 (2).

248. Another view was that there should be no limitations on the right of the innocent party to require the party in breach to perform the contract.

249. It was generally agreed that it may be possible to re-examine this question if all the proposals and suggestions were submitted to a Special Working Group whose task was to submit a unified text.

250. The Committee accordingly referred the matter to a Special Working Group consisting of the representatives of Australia, Chile, Germany, Federal Republic of, Ghana, Japan, Norway and Yugoslavia.

251. The text submitted by the Special Working Group is as follows:

"(1) The buyer may require performance by the seller unless he has resorted to a remedy which is inconsistent with such requirement [or the seller has requested the buyer to purchase goods to replace those to which the contract relates and it is reasonably practicable for the buyer to do so].

"(2) The buyer may require the seller to remedy a lack of conformity in the goods by repairing them only if the seller can do so without unreasonable inconvenience or unreasonable expense.

"(3) The buyer may require delivery of substitute goods only if the lack of conformity constitutes a fundamental breach and it is reasonably practicable for the seller to supply substitute goods.

"(4) Any request to repair or to deliver substitute goods may be made only in conjunction with notice given under article 23 or within a reasonable time thereafter."

Discussion of text submitted by Special Working Group

252. The Special Working Group reported that the words in square brackets were a further attempt by some members of the Special Working Group to deal with the problem of cover purchase. These words were not retained by the Committee in view of its previous deliberations on the matter (see paras. 239 and 240 above).

253. The Special Working Group reported that the proposed paragraph (2) made it clear that repair of defective goods was encompassed within article 27. The provision also regulated the conditions under which repair of defects in the goods could be required. The objective of the proposed paragraph (3) was to regulate the conditions under which the buyer can require delivery of substitute goods. In addition to the requirement in the present text of article 27 (2) that the defect constitute a fundamental breach, a requirement that the delivery of substitute goods also be "reasonably practicable" for the seller was added. The proposed paragraph (4) dealt with notice requirements in the same way as was done in the latter part of article 27 (2), with the exception that the notice requirement was extended to specifically include cases of repair.

254. In support of the proposed text, it was stated that it was realistic to limit the right of the buyer to require specific performance because frequently the seller would not be able to perform. Limiting the right to require specific performance also accorded with the practice of most jurisdictions which had such a remedy. Furthermore, if the costs to the seller of curing defects, or supplying substitute goods, were prohibitive, the buyer should be compelled to accept damages. This rule would coincide with the principle of mitigation of damages set out in article 59.

255. In support of proposed paragraph (2), it was stated that without such an express provision a number of legal systems would not permit the buyer to compel the seller to cure defects in goods which had been delivered. Accordingly, the proposal would ensure a similar result to that obtained in those legal systems which consider the concept of requiring "performance" to encompass cure of defective goods.

256. In opposition to the proposed article, it was stated that as the seller was in breach the buyer must have the right to compel performance. This right to demand performance of the contract should not be subject to any pre-conditions. Prior to the breach the buyer had a right to expect performance and accordingly this right should not be lessened by the fact of breach. Further, it was stated that the proposal placed the determination of whether the seller should perform the contract, *prima facie*, in the hands of the seller which could compel the innocent party to litigate to determine whether he had a right to compel performance. It was also noted that while it was clear that in many cases specific performance would be impossible and that the buyer would have to accept damages, the statement of general principle in the Convention should be that the buyer is entitled to performance of the contract.

257. The Committee, after deliberation, did not retain the proposed text of the Special Working Group. In view of this decision, the Committee did not consider a number of proposals which sought to amend the proposed text submitted by the Special Working Group.

258. Two representatives stated that as consequence of failing to deal specifically with cure, a buyer seeking redress in the courts of their legal systems would not be able to demand cure of defective goods under article 27 (1). One representative stated that, in his view, the right to demand cure was encompassed within the concept of requiring "performance" contained in article 27 (1).

Decision

259. The Committee concludes that no change of substance is called for in respect of this article, now renumbered as article 28. It therefore recommends that the Commission should adopt the following text:

"Article 28

"(1) The buyer may require performance by the seller of his obligations unless the buyer has resorted to a remedy which is inconsistent with such requirement.

"(2) If the goods do not conform with the contract, the buyer may require delivery of substitute goods only if the lack of conformity constitutes a fundamental breach and a request for substitute goods is made either in conjunction with notice given under article 23 or within a reasonable time thereafter."

ARTICLE 28

260. The text of article 28 as adopted by the Working Group on the International Sale of Goods is as follows:

"The buyer may request performance within an additional period of time of reasonable length. In such a case, the buyer cannot during such period resort to any remedy for breach of contract, unless the seller has declared that he will not comply with the request."

Effect of request for performance on remedies

261. The Committee was of the view that article 28 was intended to prevent the buyer from relying on any remedies for breach of contract during the additional period of time that he had fixed for performance. After the expiration of this period the buyer could resort to any of the remedies available to him. However, a number of representatives considered that this result may not flow from the present wording of article 28. Accordingly, the matter was referred to the Drafting Group together with a number of drafting suggestions which sought to make it clear that the purpose of article 28 was to regulate the power of the buyer to fix an additional period for performance and to define the consequences of such a request on the buyer's remedies during that period.

Nature of the additional period

262. The Commission considered a proposal that the following text be added as paragraph (2) to article 28:

"(2) Where the buyer requests the seller to perform, without fixing an additional period referred to in paragraph (1), the request is assumed [, for the purpose of the provisions thereof,] to include the fixing of a period of reasonable length."

263. In support of this proposal it was stated that the effect of a request by the buyer for performance by the seller which did not state an additional period of time for performance should be the same as a request which stated an additional specific period of time. However, a request for performance which did not state a fixed period and which was not acceded to by the seller should not authorize the buyer to avoid the contract under article 30 (1) (*b*), unless that failure to perform constituted a fundamental breach of contract under article 30 (1) (*a*).

264. It was generally considered that the essence of the *Nachfrist* principle embodied in article 28 was that the buyer had requested performance within a fixed additional period of time which was also of reasonable length. The purpose of such a period was to enable the buyer to specify the period during which he could still accept performance. The only limit to the length of the period chosen by the buyer was that it be of reasonable length. It was because the *fixed* additional period was of reasonable length that failure on the part of the seller to comply with that request enabled the buyer to declare the contract avoided under article 30 (1) (*b*).

265. The Committee accordingly did not retain the proposal to insert a provision into article 28 which would enable the mechanism of the article to be used in relation to requests for performance which did not fix an additional period of time.

266. The Committee referred article 28 to the Drafting Group to ensure that it reflected the fact that the additional period be of *fixed* duration and that the *fixed* period be of reasonable length.

267. The Committee also referred to the Drafting Group a proposal that a declaration by the seller that he will not comply with a request by the buyer for performance must arrive before it can be relied upon by the seller.

Decision

268. The Committee recommends that the Commission should adopt the following text, now renumbered as article 29:

"Article 29

"(1) The buyer may fix an additional period of time of reasonable length for performance by the seller of his obligations.

"(2) Unless the buyer has received notice from the seller that he will not perform within the period so fixed, the buyer may not, during that period, resort to any remedy for breach of contract. However, the buyer is not deprived thereby of any right he may have to claim damages for delay in the performance."

ARTICLE 29

269. The text of article 29 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) The seller may cure, even after the date for delivery, any failure to perform his obligations, if he can do so without such delay as will amount to a fundamental breach of contract and without causing the buyer unreasonable inconvenience or unreasonable expense, unless the buyer has declared the contract avoided in accordance with article 30 or has declared the price to be reduced in accordance with article 31.

"(2) If the seller requests the buyer to make known whether he will accept performance and the buyer does not comply within a reasonable time, the seller may perform within the time indicated in his request or, if no time is indicated, within a reasonable time. The buyer cannot, during either period of time, resort to any remedy which is inconsistent with performance by the seller.

"(3) A notice by the seller that he will perform within a specified period of time or within a reasonable period of time is assumed to include a request, under paragraph (2) of this article, that the buyer make known his decision."

Relationship of seller's right to cure with buyer's right to claim damages

270. The Committee decided to request the Drafting Committee to include in both article 21 and this article a reference to the fact that even though the seller cures any failure to perform his obligations the buyer still retains any right to claim damages as provided in article 55.

Paragraph (1)

Relationship of seller's right to cure with other remedies of buyer

271. The Committee considered several proposals which sought to clarify the relationship of the seller's right to remedy any failure to perform his obligations with the buyer's remedies, notably, the buyer's right to declare the contract avoided and his right to declare a reduction in the price.

272. These proposals were as follows:

(i) That the words "unless the buyer has declared the contract avoided in accordance with article 30 or has declared the price to be reduced in accordance with article 31" be deleted.

(ii) That the words "or has declared the price to be reduced in accordance with article 31" be deleted. In addition, article 31 should be amended to make it clear that the seller's right to cure his failure to perform takes precedence over the buyer's right to have the price reduced.

(iii) That the following sentence be added to paragraph (1): "The seller is, however, obliged to compensate the buyer for any expense caused by the seller in exercising his right to cure the failure to perform."

273. The central issue in discussing these proposals was whether the buyer may preclude the seller from curing any failure to perform his obligations where the cure can be effected without such delay as would amount to a fundamental breach and without causing the buyer unreasonable inconvenience or unreasonable expense. This issue was discussed in the context of a defect in the goods which, in the absence of repair, was so serious as to constitute a fundamental breach but where the delay in remedying that defect would not constitute a fundamental breach and would not even cause the buyer unreasonable inconvenience or unreasonable expense.

274. One view was that the seller's right to cure should take precedence over the buyer's right to declare the contract avoided or to declare a reduction in the price. It was stated that this rule would promote the upholding of contracts and prevent the needless expense to the seller of avoidance or price reduction where the defect could be quickly cured. The buyer would be protected by the fact that the seller's right would only operate where the cure could be effected without such delay as would constitute a fundamental breach *and* only where the cure did not cause the buyer unreasonable inconvenience or unreasonable expense. In addition the seller would have to compensate the buyer for all expenses suffered by him because of the exercise of the seller's right to cure.

275. Under another view if the defect could be cured easily there would be no fundamental breach of the contract since the notion of fundamental breach must be considered both in the light of the defect itself and in the light of the possibility for cure. However, it was pointed out this result would not be evident to many common law jurisdictions if the words "unless the buyer has declared the contract avoided in accordance with article 30" were retained in article 29 (1).

276. There was considerable opposition in the Committee to the idea that the buyer's right to declare the contract avoided could be affected by an offer to cure the defect. The seller was in breach and any possibility to cure was a privilege which depended upon the consent of the buyer who had the right to declare the contract avoided.

277. There was substantial support for the proposition that the buyer's right to declare a reduction in the price was subject to the seller's right to cure provided that the seller bore all expenses of such cure. The Committee accordingly decided to accept this principle and requested the Drafting Group to formulate appropriate language.

278. The Committee then considered the following proposals which had been submitted in the light of its deliberations:

(i) That article 29 (1) read as follows:

"(1) The seller may, at his own expense, cure, even after the date of delivery, any failure to perform his obligations, if he can do so within a reasonable time and without causing the buyer unreasonable inconvenience, unless the buyer has declared the contract avoided in accordance with article 30."

(ii) That article 29 (1) read as follows:

"(1) The seller may, at his own expense, cure, even after the date for delivery, any failure to perform his obligations, if he can do so without such delay as will amount to a fundamental breach of contract and without causing the buyer unreasonable inconvenience including any uncertainty in reimbursement by the seller of expenses advanced by the buyer, unless the buyer has declared the contract avoided in accordance with article 30."

279. It was stated in support of both of these proposals that the buyer would not bear any expenses caused by the exercise of the seller's right to cure and since the buyer would not even suffer any "unreasonable inconvenience" it was reasonable to compel the buyer to accept the cure rather than declare the contract avoided.

280. In support of the second proposal (para. 278 (ii) above), it was stated that making the exercise of the seller's right to cure subject to not causing "any uncertainty in reimbursement by the seller of expenses advanced by the buyer" would further protect the buyer and ensure an equitable distribution of rights between the parties.

281. In opposition to these proposals, it was argued that as the seller was in breach, any right to cure should be subject to the cure not causing any expense or unreasonable inconvenience to the buyer. In addition, the proposals did not make it clear that the buyer has the right to any consequential damages in addition to expenses caused by the cure.

282. Opposition to the proposals was also based on the ground that questions of reimbursement for damages should be included among the provisions on damages rather than in a provision dealing with the seller's right to cure.

283. The second proposal (para. 278 (ii) above) was also opposed on the grounds that it was too detailed for inclusion in a Convention which dealt with general matters of principle.

284. The Committee, after considerable deliberation, decided to adopt in principle the text of the second proposal set out in paragraph 278 (ii) above.

285. A representative stated that in his view article 29 (1) could not be concerned with a breach of contract in relation to the time of performance.

Paragraph (2)

286. The Committee adopted a proposal that the seller in breach bear the risk of transmission of a request to the buyer whether he would accept performance. However, the general rule in article 10 should apply to the reply of the buyer.

Paragraphs (2) and (3)

287. The Committee retained a proposal to delete the words "or, if no time is indicated, within a reasonable time" from paragraph (2) and to delete the words "or within a reasonable period of time" from paragraph (3). This decision reflected the generally accepted notion that a seller in breach who requests whether the buyer will accept performance, but does not indicate to the buyer when that performance can be expected, can draw no conclusions, nor derive any rights, from the failure of the buyer to reply.

Definition of fundamental breach

288. The Committee reconsidered the definition of fundamental breach contained in article 9 in light of the discussion on the relationship between the seller's right to cure under article 29 (1) and the buyer's right to declare the contract avoided under article 30 (1) (*a*) because of the existence of a fundamental breach of contract by the seller. This reconsideration is discussed at paragraphs 93 to 95 above.

Decision

289. The Committee adopted in principle the text set out in paragraph 278 (ii) above. It also approved in principle article 29 (2) and article 29 (3) with deletion of the words "or, if no time is indicated, within a reasonable time" from article 29 (2) and deletion of the words "or within a reasonable period of time" from article 29 (3). An additional paragraph was added to reflect the fact that the seller bears the risk in transmission of a request to the buyer whether he will accept performance. Accordingly the Committee recommends that the Commission should adopt the following text, now renumbered as article 30:

"Article 30

"(1) Unless the buyer has declared the contract avoided in accordance with article 31, the seller may, even after the date for delivery, remedy at his own expense any failure to perform his obligations, if he can do so without such delay as will amount to a fundamental breach of contract and without causing the buyer unreasonable inconvenience or uncertainty of reimbursement by the seller of expenses advanced by the buyer. The buyer retains any right to claim damages as provided for in this Convention.

"(2) If the seller requests the buyer to make known

whether he will accept performance and the buyer does not comply with the request within a reasonable time, the seller may perform within the time indicated in his request. The buyer may not, during that period of time, resort to any remedy which is inconsistent with performance by the seller.

"(3) A notice by the seller that he will perform within a specified period of time is assumed to include a request, under paragraph (2) of this article, that the buyer make known his decision.

"(4) A request or notice by the seller under paragraphs (2) and (3) of this article is not effective unless received by the buyer."

ARTICLE 30

290. The text of article 30 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) The buyer may declare the contract avoided:

"(*a*) If the failure by the seller to perform any of his obligations under the contract and this Convention amounts to a fundamental breach of contract; or

"(*b*) If the seller has been requested to make delivery under article 28 and has not delivered the goods within the additional period of time fixed by the buyer in accordance with that article or has declared that he will not comply with the request.

"(2) However, in cases where the seller has made delivery, the buyer loses his right to declare the contract avoided unless he has done so within a reasonable time:

"(*a*) In respect of late delivery, after he has become aware that delivery has been made; or

"(*b*) In respect of any breach other than late delivery, after he knew or ought to have known of such breach or, if the buyer has requested the seller to perform under article 28, after the expiration of the additional period of time or after the seller has declared that he will not comply with the request."

Subparagraph (1) (b)

291. The Committee considered a proposal that the words "if the seller has been requested to make delivery" be followed by "or to cure a lack of conformity". In support of this proposal it was stated that the buyer's right to declare the contract avoided should exist where the seller does not cure a lack of conformity when requested to do so pursuant to article 28, as well as when he does not make delivery pursuant to that article. The possibility that the buyer might attempt to abuse this right by insisting that the seller's failure to cure a minor lack of conformity in the goods gave grounds to avoid the contract could be prevented by adding a provision similar to article 33 (2) of ULIS that "no difference in quantity, lack of part of the goods or absence of any quality or characteristic shall be taken into consideration where it is not material".

292. However, under another view the proposal might give unwarranted power to a buyer to avoid the contract for a lack of conformity in the goods which, although not minimal, would not be very serious.

293. The Committee, after deliberation, did not retain this proposal.

Subparagraph (2) (b)

294. The Committee considered a proposal that article 30 (2) (*b*) should apply also to the cases envisaged by articles 29 paragraphs (2) and (3). In other words, if the seller had made delivery, the buyer would lose his right to declare the contract avoided if he did not do so within a reasonable time after the expiration of any additional period of time requested by the seller for performance pursuant to those articles.

295. The Committee did not retain this proposal. It was considered inappropriate to include a reference to article 29 in article 30 (2) (*b*) since the period in article 29 is set by the seller who is in breach. The fact that the period which he has set had expired should not affect the rights of the innocent buyer.

Unilateral declarations of avoidance

296. The view was expressed by several representatives that article 30 improperly granted to the buyer the power to declare the contract avoided unilaterally and without the intervention of a court or tribunal. It was noted that article 30 was but the first of several articles which granted the injured party the power to act unilaterally. Although those representatives did not oppose at this stage the adoption of article 30, or of the other articles which granted to the injured party a similar power, they requested that their views be noted in this report.

Decision

297. The Committee concludes that no change in substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 31.

"Article 31

"(1) The buyer may declare the contract avoided:

"(*a*) If the failure by the seller to perform any of his obligations under the contract and this Convention amounts to a fundamental breach of contract; or

"(*b*) If the seller has not delivered the goods within the additional period of time fixed by the buyer in accordance with paragraph (1) of article 29 or has declared that he will not deliver within the period so fixed.

"(2) However, in cases where the seller has made delivery, the buyer loses his right to declare the contract avoided unless he has done so within a reasonable time:

"(*a*) In respect of late delivery, after he has become aware that delivery has been made; or

"(*b*) In respect of any breach other than late delivery, after he knew or ought to have known of such breach, or after the expiration of any additional period of time fixed by the buyer in accordance with paragraph (1) of article 29, or after the seller has declared that he will not perform his obligations within such an additional period."

ARTICLE 31

298. The text of article 31 as adopted by the Working Group on the International Sale of Goods is as follows:

"If the goods do not conform with the contract and whether or not the price has already been paid, the buyer may declare the price to be reduced in the same proportion as the value of the goods at the time of the conclusion of the contract has been diminished because of the non-conformity."

Relationship with seller's right to cure

299. In accordance with its decision in relation to article 29 (see para. 277 above), the Committee was agreed that the declaration of reduction of the price was subject to the seller's right to cure defects under article 29 and that, therefore, a declaration of price reduction would have no effect if the seller subsequently cured the defect pursuant to article 29.

Calculation of diminished value

300. The Committee decided to redraft the provision to make it clear that the proportion by which the price was to be reduced is the same proportion as that existing between the value that the goods actually delivered would have had at the time of the conclusion of the contract and the value that conforming goods would have had at that time.

Unilateral reduction of the price

301. The view was expressed by several representatives that article 31, like article 30, improperly granted the buyer unilateral

power to effect the remedy in question, in this case reduction of the price. It was stated that once the buyer had declared a reduction of the price, the only question which might come before a court was the propriety of the amount by which the price was reduced.

302. Under another view, a court or tribunal would also have the power to review whether the fact of a price reduction was justified because of, for example, a cure of the lack of conformity by the seller.

Decision

303. The Committee concludes that no change in substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 32:

"Article 32

"If the goods do not conform with the contract and whether or not the price has already been paid, the buyer may declare the price to be reduced in the same proportion as the value that the goods actually delivered would have had at the time of the conclusion of the contract bears to the value that conforming goods would have had at that time. However, if the seller remedies any failure to perform his obligations in accordance with article 30 or if he is not allowed by the buyer to remedy that failure in accordance with that article, the buyer's declaration of reduction of the price is of no effect."

ARTICLE 32

304. The text of article 32 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) If the seller delivers only a part of the goods or if only a part of the goods delivered is in conformity with the contract, the provisions of articles 27 to 31 apply in respect of the part which is missing or which does not conform.

"(2) The buyer may declare the contract avoided in its entirety only if the failure to make delivery completely and in conformity with the contract amounts to a fundamental breach of the contract."

Paragraph (2)

305. The Committee decided that paragraph (2) should be drafted in such a manner as to make it clear that the buyer had the power to declare the contract avoided under this provision where there was either a failure to make a complete delivery or a failure to deliver goods which conform to the contract.

Decision

306. The Committee concludes that no change in substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 33:

"Article 33

"(1) If the seller delivers only a part of the goods or if only a part of the goods delivered is in conformity with the contract, the provisions of articles 28 to 32 apply in respect of the part which is missing or which does not conform.

"(2) The buyer may declare the contract avoided in its entirety only if the failure to make delivery completely or in conformity with the contract amounts to a fundamental breach of the contract."

ARTICLE 33

307. The text of article 33 as adopted by the Working Group on the International Sale of Goods is as follows:

"(1) If the seller delivers the goods before the date fixed, the buyer may take delivery or refuse to take delivery.

"(2) If the seller delivers a quantity of goods greater than that provided for in the contract, the buyer may take delivery or refuse to take delivery of the excess quantity. If the buyer takes delivery of all or part of the excess quantity, he must pay for it at the contract rate."

Article as a whole

308. The Committee considered a proposal to add the following words to paragraph (1):

"If the buyer takes delivery before the date fixed, he must pay the price at a correspondingly earlier date. If the buyer refuses to take delivery, he may do so only within a reasonable time, otherwise he loses his right to refuse."

and the following words to paragraph (2):

"In case the buyer does not refuse to take delivery of the goods within a reasonable time, at the latest, however, within three months after passing of the risk, or if he uses or disposes of the goods, delivery of the excess quantity is regarded as taken."

309. In support of this proposal, it was stated that the additions to the text would specify the consequences flowing from a decision by the buyer to take delivery or to refuse to take delivery. In particular, it was stated, if the buyer takes early delivery, it is only equitable that he make a correspondingly earlier payment of the purchase price. Further, if the buyer refuses to take delivery, that refusal should only be permitted within a reasonable time after the goods arrive.

310. However, there was considerable opposition to the notion that a buyer who takes early delivery must make a correspondingly early payment of the purchase price. It was stated that early delivery was a breach of contract by the seller and consequently the buyer should not be penalized because he took early delivery of the goods to accommodate the seller. In addition, a rule which compelled early payment would tend to encourage rejection of the goods which was an undesirable result. In any case, the question of change in payment terms should be left to the negotiations between the parties since such negotiations could easily take place at the time the buyer was considering whether to take early delivery of the goods. It was undesirable to restrict the freedom of the parties by requiring, unless otherwise agreed, that early delivery entailed early payment.

311. There was also opposition to the concept of permitting the buyer to refuse to take delivery "within a reasonable time" after delivery or within three months after the risk had passed. It was stated that the existing text of article 33 made it clear that the refusal to take delivery must be made when the goods were tendered to the buyer and there seemed to be no reason to relax this requirement. The proposal also created difficulties since it was difficult to envisage how the buyer who had accepted the goods could refuse to take delivery at a later time.

312. The Committee, after deliberation, did not retain the proposal.

Paragraph (1)

313. The Committee also did not retain, for reasons similar to those outlined in paragraph 311 above, a proposal that the following words be added to paragraph (1):

"however the buyer must take delivery before the date fixed if it is unreasonable to refuse it and the seller has reason for such delivery".

Decision

314. The Committee concludes that no change of substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 34:

"Article 34

"(1) If the seller delivers the goods before the date fixed, the buyer may take delivery or refuse to take delivery.

"(2) If the seller delivers a quantity of goods greater than that provided for in the contract, the buyer may take delivery or refuse to take delivery of the excess quantity. If the buyer takes delivery of all or part of the excess quantity, he must pay for it at the contract rate."

ARTICLE 34

315. The text of article 34 as adopted by the Working Group on the International Sale of Goods is as follows:

"The buyer must pay the price for the goods and take delivery of them as required by the contract and this Convention."

Decision

316. The Committee concludes that no change of substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 35:

"Article 35

"The buyer must pay the price for the goods and take delivery of them as required by the contract and this Convention."

ARTICLE 35

317. The text of article 35 as adopted by the Working Group on the International Sale of Goods is as follows:

"The buyer must take the necessary steps to enable the price to be paid or to procure the issuance of documents assuring payment, such as a letter of credit or a banker's guarantee."

Deletion of article 35

318. The Committee considered a proposal to delete article 35. In support of this proposal it was stated that the obligation to pay the price is already stated in article 34. Included in that obligation is the obligation to take all necessary steps to enable the price to be paid. It was noted that there was no parallel provision in the Convention that the seller must take the necessary steps to enable the goods to be delivered. The view was also expressed that the provision raises questions as to which documents were envisaged.

319. In opposition to the proposal to delete article 35, it was stated that the provision served a useful purpose in indicating that the buyer's obligation to pay may encompass several steps prior to the date of payment. It also gave an indication of the form in which the obligation to pay the price or to assure its payment may be required to be performed.

320. The Committee, after deliberation, decided not to retain this proposal.

Redrafting article 35

321. The Committee concluded that the discussion in respect of the proposal to delete article 35 had demonstrated that it should not be drafted in such a manner as to appear to apply to the steps necessary for the buyer to cause his bank to pay the price but only to the steps necessary to assure that the price can be paid, such as the obligation of applying for permission to remit foreign exchange.

Decision

322. The Committee, after deliberation, recommends that the Commission should adopt the following text, now renumbered as article 36:

"Article 36

"The buyer's obligation to pay the price includes taking such steps and complying with such formalities as may be required under the contract or any relevant laws and regulations to enable payment to be made."

ARTICLE 36

323. The text of article 36, as adopted by the Working Group on the International Sale of Goods, is as follows:

"When a contract has been concluded but does not state the price or expressly or impliedly make provision for the determination of the price of the goods, the buyer must pay the price generally charged by the seller at the time of the conclusion of the contract. If no such price is ascertainable, the buyer must pay the price generally prevailing at the aforesaid time for such goods sold under comparable circumstances."

324. This article, which was the subject of considerable discussion, was examined under the following major headings: (i) deletion of article 36; (ii) various proposals for the amendment of article 36; (iii) proposal for placing article 36 in square brackets.

(i) *Deletion of article 36*

325. Support for the proposal to delete the article was based on the fact that price was an essential element of a contract of sale and there could be no contract between the parties unless a price had been determined or was determinable from the agreement between the parties. If the price was not ascertainable in this way, the Courts should not impose a price on the parties. This was a commercially sound rule since it would be a very rare case where there was in fact a concluded agreement but no express or implied agreement on the price. Under another view, article 36 related to matters of formation and validity of contracts and it was thus inappropriate to include it in a Convention on Sales but the question should rather be dealt with in the future Convention on Formation and Validity. Finally it was noted that many legal systems considered that a determined or determinable price was an essential ingredient of a contract and accordingly article 36 would have no application in those legal systems. It was thus more appropriate to leave the question of price determination in such agreements to those legal systems which recognized the validity of those agreements.

326. In support of the retention of article 36, it was stated that the article did not confer validity on an agreement in which the price was neither determined nor determinable. The article merely provided a uniform method for the calculation of the price if the applicable law enabled the agreement in question to constitute a valid contract. It was useful to have such a rule since some goods, for instance spare parts, were frequently ordered, and later dispatched, without reference to price. If such a transaction was valid by the applicable law, it would be preferable to have a common provision for the determination of price rather than leave the matter to widely differing national law rules governing the determination of price. It was also stated that as the future Convention on Formation and Validity was not yet finalized, it was very important to retain article 36 to determine the price in agreements without a determined or determinable price which are considered valid by the applicable law.

327. The Committee, after discussion, by a narrow majority, retained article 36.

(ii) *Various proposals for amendment of article 36*

(a) *Limitation of application to valid agreements*

328. In view of the lack of consensus to retain article 36, there was considerable support in the Committee for a number of proposals which sought to have a clear statement in article 36 that the provision only operated if the agreement was otherwise valid pursuant to the applicable national law. There was, how-

ever, some opposition to the inclusion of this express statement in article 36. This view was based on the fact that the entire draft Convention proceeded on the assumption that there was a valid contract in existence. Accordingly, the introduction of an express statement to this effect in only one provision could well cause difficulties of interpretation in relation to other provisions.

329. The Committee, after deliberation, decided to introduce an express statement into article 36 to make it clear that the provision only applied to agreements which were considered valid by the applicable law. The precise wording of this statement was referred to the Drafting Group.

330. One representative expressed a reservation in respect of this decision.

(b) *Change in criteria for determining price*

331. It was suggested that it would be more equitable to make as the primary rule for price determination the price generally prevailing at the time of the conclusion of the contract for substitute goods sold under comparable circumstances. Only if there was no such price should the determination of the price be made by reference to that generally charged by the seller at the conclusion of the contract.

332. Under another view, the existing text of article 36 was preferable. Since the buyer had chosen to deal with that particular seller, it should be assumed that the buyer anticipated that he would pay the price generally charged by that seller. This assumption was strengthened by the fact that no price was stated in the agreement. This was particularly important where the seller was marketing goods at a comparatively low price.

333. The Committee, after deliberation, retained the original order of methods used for calculation of the price, i.e. the primary rule was the price generally charged by the seller at the time of the conclusion of the contract and only if no such price was determinable would the price be determined by reference to the market price.

334. The Commission did not retain a suggestion that the choice between the two methods of price determination be resolved in favour of the method which produced the lower price.

335. The Committee also considered the following proposals, which did not attract sufficient support for retention:

(i) That the price be determined as at the time of delivery rather than as at the time of the conclusion of the contract;

(ii) That article 36 state the place at which the market price is to be calculated;

(iii) That the last sentence of article 36 be deleted so that the price can be determined by the article only when there is a price generally charged by the seller at the time of the conclusion of the contract.

(iii) *Proposal for placing article 36 in square brackets*

336. It was proposed that, in view of the narrow majority for the retention of article 36, it would better accord with the Commission's principle of arriving at decisions by consensus if the text of the article were placed in square brackets. However, under another view the question of the size of the majority was not decisive since a number of provisions had been retained by small majorities. It was also stated that it would be preferable to propose a text for the consideration of the diplomatic conference rather than place the provision in square brackets which would indicate that no agreement had been possible.

337. The Committee, after deliberation, did not retain the proposal to place article 36 in square brackets.

Reservations

338. The representatives of Ghana, the Philippines and the Union of Soviet Socialist Republics expressed their formal reservation to article 36 and requested that these reservations together with the names of those delegations be recorded not only in the report but also in a foot-note to the text of article 36 of the draft Convention.

339. An observer also expressed his disagreement with article 36.

Decision

340. The Committee decided to introduce an express statement into the article to make it clear that it only applied to agreements which were considered valid by the applicable law. It therefore recommends that the Commission should adopt the following text, now renumbered as article 37:

"Article 37

"If a contract has been validly concluded but does not state the price or expressly or impliedly make provision for the determination of the price of the goods, the buyer must pay the price generally charged by the seller at the time of the conclusion of the contract. If no such price is ascertainable, the buyer must pay the price generally prevailing at the aforesaid time for such goods sold under comparable circumstances."

ARTICLE 37

341. The text of article 37, as approved by the Working Group on the International Sale of Goods, is as follows:

"If the price is fixed according to the weight of the goods, in case of doubt it is to be determined by the net weight."

Decision

342. The Committee concludes that no change of substance is called for in respect of article 37. It therefore recommends that the Commission should adopt the following text, now renumbered as article 38:

"Article 38

"If the price is fixed according to the weight of the goods, in case of doubt it is to be determined by the net weight."

ARTICLE 38

343. The text of article 38, as approved by the Working Group on the International Sale of Goods, is as follows:

"(1) The buyer must pay the price to the seller at the seller's place of business. However, if the payment is to be made against the handing over of the goods or of documents, the price must be paid at the place where the handing over takes place.

"(2) The seller must bear any increase in the expenses incidental to payment which is caused by a change in the place of business of the seller subsequent to the conclusion of the contract."

344. One representative indicated that the definition of "place of business" contained in article 6 (*a*) was difficult to apply to paragraph (1) of this article and almost impossible to apply to paragraph (2).

Decision

345. The Committee decides that no change of substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 39:

"Article 39

"(1) If the buyer is not bound to pay the price at any other particular place, he must pay it to the seller:

"(*a*) At the seller's place of business; or

"(*b*) If the payment is to be made against the handing over of the goods or of documents, at the place where the handing over takes place.

"(2) The seller must bear any increase in the expenses incidental to payment which is caused by a change in the

place of business of the seller subsequent to the conclusion of the contract."

ARTICLE 39

346. The text of article 39, as approved by the Working Group on the International Sale of Goods, is as follows:

"(1) The buyer must pay the price when the seller places either the goods or a document controlling their disposition at the buyer's disposal in accordance with the contract and this Convention. The seller may make such payment a condition for handing over the goods or document.

"(2) If the contract involves carriage of the goods, the seller may dispatch the goods on terms whereby the goods, or documents controlling their disposition, will not be handed over to the buyer at the place of destination except against payment of the price.

"(3) The buyer is not required to pay the price until he has had an opportunity to examine the goods, unless the procedures for delivery or payment agreed upon by the parties are inconsistent with such opportunity."

Paragraph (3)

347. The Committee considered a proposal that the words "unless the procedures for delivery or payment agreed upon by the parties are inconsistent with such opportunity" be deleted as they did not add anything to the notion of supremacy of the will of the parties contained in article 5. However, there was no support for this proposal because the procedures agreed upon for delivery of the goods may not deal explicitly with payment of the purchase price yet indicate that payment is to be made prior to examination of the goods. Accordingly, the original provision was considered to serve a useful purpose and was retained by the Committee.

Decision

348. The Committee concludes that no change of substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 40:

"Article 40

"(1) The buyer must pay the price when the seller places either the goods or documents controlling their disposition at the buyer's disposal in accordance with the contract and this Convention. The seller may make such payment a condition for handing over the goods or documents.

"(2) If the contract involves carriage of the goods, the seller may dispatch the goods on terms whereby the goods, or documents controlling their disposition, will not be handed over to the buyer except against payment of the price.

"(3) The buyer is not bound to pay the price until he has had an opportunity to examine the goods, unless the procedures for delivery or payment agreed upon by the parties are inconsistent with his having such an opportunity."

ARTICLE 40

349. The text of article 40, as approved by the Working Group on the International Sale of Goods, is as follows:

"The buyer must pay the price on the date fixed or determinable by the contract or this Convention without the need for any formalities."

350. The Committee considered a proposal that article 40 read as follows:

"The buyer must pay the price on the date fixed or determinable by the contract or this Convention without the need for any request or other formality on the part of the seller."

351. There was general support for this proposal which would make it clear that the buyer's obligation to pay the price on a date fixed or determinable by the contract and the Convention was not dependent upon the seller making a request or going through any other formality. The proposal was therefore adopted.

Decision

352. The Committee adopted in substance the proposal to amend this article to specify that the article is concerned only with eliminating the need for formalities on the part of the seller. It therefore recommends that the Commission should adopt the following text, now renumbered as article 41:

"Article 41

"The buyer must pay the price on the date fixed by or determinable from the contract and this Convention without the need for any request or other formality on the part of the seller."

ARTICLE 41

353. The text of article 41, as approved by the Working Group on the International Sale of Goods, is as follows:

"The buyer's obligation to take delivery consists:

"(*a*) In doing all the acts which could reasonably be expected of him in order to enable the seller to make delivery, and

"(*b*) In taking over the goods."

Subparagraph (a)

354. The proposal was made that the obligation of the buyer under subparagraph (*a*) should consist in "not doing acts which would prevent the seller to effect delivery". Support for this proposal was based on the view that the existing text placed too onerous a burden on the buyer. It was noted that the seller must deliver the goods and that all that should be expected of the buyer is that he does not hinder the seller in performing his contractual obligation to deliver. This proposal was not retained since it was generally considered that there were many instances in international trade where active assistance from the buyer would be required to effect delivery e.g., precise delivery instructions or assisting in overcoming local administrative problems which would be exceptionally difficult for a seller, located in a distant country, to deal with.

Subparagraph (b)

355. The Committee considered a proposal that subparagraph (*b*) should read as follows:

"(*b*) In taking over the goods on such date or at any time within such period as fixed or determinable by agreement or usage or, in any other case, within a reasonable time after the goods were placed at his disposal."

356. The proposal was based on the grounds that it would overcome the deficiency in the present text of not indicating the time when the goods must be taken over by the buyer. It was important to be able to determine this point of time since article 66 (2) provided that in certain circumstances "the risk passes to the buyer at the last moment he could have taken over the goods without committing a breach of the contract".

357. However, the Committee did not retain this proposal as it was considered that article 17 defined the time at which the seller must deliver the goods and article 34 already indicated when those goods must be taken over by the buyer, although the proposal added a new alternative criterion of taking over the goods within a reasonable time after those goods were placed at the disposal of the buyer. It was also considered that this added alternative requirement, with its reference to goods being placed at the disposal of the buyer, would be difficult to apply in connexion with documentary sales.

Decision

358. The Committee concludes that no change in substance is called for in respect of this article. It therefore recom-

mends that the Commission should adopt the following text, now renumbered as article 42:

"Article 42

"The buyer's obligation to take delivery consists:

"(*a*) In doing all the acts which could reasonably be expected of him in order to enable the seller to make delivery; and

"(*b*) In taking over the goods."

PROPOSED ARTICLE 41 BIS

359. The Committee considered a proposal that a new article 41 *bis* be added to the Convention. The text of this proposed article is as follows:

"The buyer may terminate [cancel] a contract of sale of goods in which he has ordered the goods to be manufactured by the seller in accordance with specifications set out in the contract or given by the buyer, provided he gives the seller notice thereof before the manufacture has been completed and further provided that it does not cause the seller unreasonable inconvenience to discontinue the manufacture. The buyer must pay damages in accordance with the provisions of articles 55, 56, [57] and 59, which apply correspondingly."

360. Support for this proposal was based on the fact that in contracts for the sale of goods by specification, changes in circumstances may make acceptance of those goods financially burdensome for the buyer. From the seller's point of view, the market value of specialized goods made to order could frequently be less than their cost of production. It therefore accorded with equity to enable the buyer to terminate the contract before the manufacture was complete, provided that this did not cause the seller unreasonable inconvenience. In addition, the buyer must pay any damages to the seller, including his loss of profits, resulting from the termination.

361. Although there was sympathy for the objectives of the proposed article 41 *bis*, it was generally considered that the proposal caused more difficulties than it solved. In particular, the concept that the buyer would be liable for all damages including loss of profits was criticized as was the idea of attempting to apply articles 56 and 57 to a termination situation. Under one view, the proper approach would be to require the buyer to pay the purchase price less any savings caused by the termination of production. It was also suggested that the place for such a rule would be in article 45, or possibly in article 59 on mitigation.

Decision

362. The Committee, after deliberation, decided not to retain the proposal to introduce a new article 41 *bis*.

ARTICLE 42

363. The text of article 42, as approved by the Working Group on the International Sale of Goods, is as follows:

"(1) If the buyer fails to perform any of his obligations under the contract and this Convention, the seller may:

"(*a*) exercise the rights provided in articles 43 to 46;

"(*b*) claim damages as provided in articles 55 to 59.

"(2) The seller is not deprived of any right he may have to claim damages even though he exercises his right to other remedies.

"(3) If the seller resorts to a remedy for breach of contract, the buyer is not entitled to apply to a court or arbitral tribunal to grant him a period of grace."

Combination of remedy provisions

364. The Committee did not retain a suggestion that the remedy provisions for breach of contract by the buyer be combined with those for breach of contract by the seller.

Decision

365. The Committee concludes that no change of substance is called for in respect of this article although its drafting should conform to that of article 26. It therefore recommends that the Commission should adopt the following text, now renumbered as article 43:

"Article 43

"(1) If the buyer fails to perform any of his obligations under the contract and this Convention, the seller may:

"(*a*) Exercise the rights provided in articles 44 to 47;

"(*b*) Claim damages as provided in articles 56 to 59.

"(2) The seller is not deprived of any right he may have to claim damages by exercising his right to other remedies.

"(3) No period of grace may be granted to the buyer by a court or arbitral tribunal when the seller resorts to a remedy for breach of contract."

ARTICLE 43

366. The text of article 43, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The seller may require the buyer to pay the price, take delivery or perform any of his other obligations, unless the seller has resorted to a remedy which is inconsistent with such requirement."

Limitation on seller's rights under article 43

367. The Committee considered a proposal that article 43 read as follows (italicized words are additions to the existing text):

"The seller, *after he has duly complied with his obligation under the contract,* may require the buyer to pay the price, take delivery or perform any of his other obligations, unless the seller has resorted to a remedy which is inconsistent with such requirement."

368. Support for this proposal was based on the proposition that the seller should be able to require the buyer to perform his obligations (in practice, usually to pay the price) only if the seller had already performed his own obligations under the contract.

369. However, there was considerable opposition to this proposal on the ground that it would create difficulties in practice. For instance, it was noted that the contract may call for payment of the price before the goods were delivered or the contract may require the opening of a letter of credit prior to delivery. It was also pointed out that the proposal would upset the balance of rights and obligations between the seller and the buyer.

370. The Committee, after deliberation, did not retain the proposal.

Relationship of action for price with principle of mitigation

371. The Committee decided to consider a proposal that would make the right to require payment of the price subject to the principle of mitigation in conjunction with its examination of the principle of mitigation in article 59 (see paras. 502-505 below).

Decision

372. The Committee concludes that no change of substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 44:

"Article 44

"The seller may require the buyer to pay the price, take delivery or perform his other obligations, unless the seller has resorted to a remedy which is inconsistent with such requirement."

ARTICLE 44

373. The text of article 44, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The seller may request performance within an additional period of time of reasonable length. In such a case, the seller cannot during such period resort to any remedy for breach of contract, unless the buyer has declared that he will not comply with the request."

374. The Commission considered a proposal that the following paragraph be added to article 44:

"Where the seller has not requested performance, the buyer may request the seller to make known whether he will accept performance. If the seller does not comply within a reasonable time, the buyer may perform within the time indicated in his request. The seller cannot, during either period of time, resort to any remedy which is inconsistent with performance by the buyer. A notice by the buyer that he will perform within a specified period of time is assumed to include a request under this paragraph that the seller make known his decision."

375. It was stated that this proposal, which was modelled on articles 29 (2) and 29 (3), would thus achieve a balance between the rights of buyer and seller.

376. However, under another view the proposal was unnecessary and would merely complicate the text of the Convention. It was pointed out that the primary obligation of the buyer is to pay the price and, once this is paid, the seller loses the right to declare the contract avoided in respect of any late performance by the buyer unless the seller has avoided the contract before that late performance is rendered (article 45 (2)).

377. The Committee did not retain this proposal.

Risk of loss or errors in transmission

378. The Committee was agreed that the rule in article 10 should be reversed in relation to declarations by the defaulting buyer that he will not comply with the request for performance by the seller. Consequently, the buyer would bear the consequences of any loss, delay or errors in transmission of the notice. The implementation of this principle was referred to the Drafting Group.

Decision

379. The Committee adopted, in principle, the present text of article 44 with the exception that the risk of loss, delay or errors in transmission of declarations of non-compliance by the defaulting buyer are placed on that buyer. The Committee therefore recommends that the Commission adopt the following text, now renumbered as article 45:

"Article 45

"(1) The seller may fix an additional period of time of reasonable length for performance by the buyer of his obligations.

"(2) Unless the seller has received notice from the buyer that he will not perform within the period so fixed, the seller may not, during that period, resort to any remedy for breach of contract. However, the seller is not deprived thereby of any right he may have to claim damages for delay in the performance."

ARTICLE 45

380. The text of article 45, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) The seller may declare the contract avoided:

"(*a*) If the failure by the buyer to perform any of his obligations under the contract and this Convention amounts to a fundamental breach of contract; or

"(*b*) If the buyer has been requested under article 44 to pay the price or to take delivery of the goods and has not paid the price or taken delivery within the additional period of time fixed by the seller in accordance with that article or has declared that he will not comply with the request.

"(2) However, in cases where the buyer has paid the price, the seller loses his right to declare the contract avoided if he has not done so:

"(*a*) In respect of late performance by the buyer, before the seller has become aware that performance has been rendered; or

"(*b*) In respect of any breach other than late performance, within a reasonable time after the seller knew or ought to have known of such breach or, if the seller has requested the buyer to perform under article 44, within a reasonable time after the expiration of the additional period of time or after the buyer has declared that he will not comply with the request."

Paragraph (1)

381. The Committee did not retain a proposal that article 45 (1) be amended to the effect that if the seller had allowed the buyer to take possession of the goods, he could not take them back from the buyer unless the buyer had failed to pay the price within the additional period set by the seller pursuant to article 44.

Subparagraph (1) (b)

382. The Committee considered a proposal that article 45 (1) (*b*) be amended to read as follows:

"(*b*) If the buyer has been requested under article 44 to pay the price, or to take the steps with respect to payment required under article 35, or to take delivery of the goods, and has not complied with the request within the additional period of time fixed by the seller in accordance with article 44 or has declared that he will not comply with the request."

383. In support of this proposal, it was noted that in international sales the critical step in the buyer's performance was often not the buyer's actual payment of the price but the establishment of a letter of credit or a bankers' guarantee. These steps were within the concept of "request performance" in article 44 but the present text of article 45 (1) (*b*), in implementing article 44, provided merely for avoidance by the seller if the buyer, after a request, had failed "to pay the price or take delivery". This failure "to pay" would not include a failure to take the steps required under article 35 to ensure payment.

384. The Committee, after deliberation, retained the substance of this proposal.

Paragraph (2)

385. The Committee considered a proposal that article 45 (2) be amended to read as follows:

"(2) However, in cases where the buyer had paid the price the seller loses his right to declare the contract avoided if he has not done so:

"(*a*) In respect of late payment, before the seller has become aware that payment has been made; or

"(*b*) In respect of any other breach than late payment, within a reasonable time after the seller knew or ought to have known of such breach, or after the expiration of any additional period of time applicable under article 44."

386. In support of this proposal, it was stated that it was necessary to distinguish cases of late payment of the purchase price from all other breaches. In the case of late payment, the right to declare the contract avoided should be lost if not done before the seller had become aware that payment had been made. However, in respect of any other breach the seller should be able to declare the contract avoided even after he has received payment, if he has requested performance by the buyer under article 44.

387. There was considerable opposition to narrowing the scope of application of article 45 (2) (*a*) to cases of late payment and dealing with all other matters under article 45 (2) (*b*). It was considered that if the buyer had paid the price, the

seller should lose the right to declare the contract avoided in respect of any late performance if he had not done so before becoming aware that the buyer had performed.

388. The Committee, accordingly, did not retain the proposal.

Subparagraph (2) (a)

389. The Committee considered a proposal that article 45 (2) (*a*) read as follows:

"(*a*) In respect of late performance by the buyer within a reasonable time after the seller has become aware that payment has been rendered; or"

390. In support of this proposal it was stated that the present text of article 45 (2) (*a*) could result in harsh results in cases where payment is due before delivery of the goods. Should the payment not eventuate, the seller may reasonably assume that the transaction is at an end and sell the goods to a third party. If the buyer subsequently pays the purchase price the seller should have a reasonable period of time to declare the contract avoided.

391. Under another view the seller should be compelled to declare the contract avoided before he becomes aware of performance. This was a clear rule and works no hardship as the seller will know when performance is due and can react if that performance is late.

392. The Committee, after deliberation, decided not to retain the proposal.

393. The Committee also considered, but did not retain, a proposal that if the goods were delivered but the price had not been paid the seller would have to require that payment of the price be made within an additional period or the right to declare the contract avoided would be lost.

Decision

394. The Committee decided to adopt, in principle, the present text of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 46:

"*Article 46*

"(1) The seller may declare the contract avoided:

"(*a*) If the failure by the buyer to perform any of his obligations under the contract and this Convention amounts to a fundamental breach of contract; or

"(*b*) If the buyer has not, within the additional period of time fixed by the seller in accordance with paragraph (1) of article 45, performed his obligation to pay the price or taken delivery of the goods, or if he has declared that he will not do so within the period so fixed.

"(2) However, in cases where the buyer has paid the price, the seller loses his right to declare the contract avoided if he has not done so:

"(*a*) In respect of late performance by the buyer, before the seller has become aware that performance has been rendered; or

"(*b*) In respect of any breach other than late performance, within a reasonable time after he knew or ought to have known of such breach, or within a reasonable time after the expiration of any additional period of time fixed by the seller in accordance with paragraph (1) of article 45 or the declaration by the buyer that he will not perform his obligations within such an additional period."

ARTICLE 46

395. The text of article 46, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) If under the contract the buyer is to specify the form, measurement or other features of the goods and he fails to make such specification either on the date expressly or impliedly agreed upon or within a reasonable time after receipt of a request from the seller, the seller may, without prejudice to any other rights he may have, make the specification himself in accordance with any requirement of the buyer that may be known to him.

"(2) If the seller makes the specification himself, he must inform the buyer of the details thereof and must fix a reasonable time within which the buyer may submit a different specification. If the buyer fails to do so, the specification made by the seller is binding."

Paragraph (2)

396. The Committee adopted, subject to drafting changes, a proposal that the last sentence of paragraph (2) read:

"If the buyer fails to do so after having received the request, the specification made by the seller is binding."

This amendment ensures that the risk of transmission of the specification made by the seller is on the seller.

Decision

397. The Committee therefore recommends that the Commission should adopt the following text, now renumbered as article 47:

"*Article 47*

"(1) If under the contract the buyer is to specify the form, measurement or other features of the goods and he fails to make such specification either on the date agreed upon or within a reasonable time after receipt of a request from the seller, the seller may, without prejudice to any other rights he may have, make the specification himself in accordance with any requirement of the buyer that may be known to him.

"(2) If the seller makes the specification himself, he must inform the buyer of the details thereof and must fix a reasonable time within which the buyer may make a different specification. If the buyer fails to do so after receipt of such a communication, the specification made by the seller is binding."

ARTICLE 47

398. The text of article 47, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) A party may suspend the performance of his obligations if it is reasonable to do so because, after the conclusion of the contract, a serious deterioration in the capacity to perform or creditworthiness of the other party or his conduct in preparing to perform or in actually performing the contract gives grounds to conclude that the other party will not perform a substantial part of his obligations.

"(2) If the seller has already dispatched the goods before the grounds described in paragraph (1) of this article become evident, he may prevent the handing over of the goods to the buyer even though the buyer holds a document which entitles him to obtain them. This paragraph relates only to the rights in the goods as between the buyer and the seller.

"(3) A party suspending performance, whether before or after dispatch of the goods, must immediately give notice to the other party thereof and must continue with performance if the other party provides adequate assurance of his performance. If the other party fails to provide such assurance within a reasonable time after he has received the notice, the party who suspended performance may avoid the contract."

Proposal for deletion of article 47

399. The Committee considered a proposal to delete article 47.

400. In support of this proposal, it was stated that the right given to one party to suspend his contractual obligations, and later to avoid the contract, gave too much power to that party because the exercise of that right was primarily dependent on

his own subjective assessment of the other party's future course of conduct. Such a right was stated to be too easy of abuse, particularly by those representatives who considered that a party's assessment as to whether the other party would not perform a substantial part of his obligations was not subject to judicial review.

401. In opposition to this proposal it was stated that article 47 served a useful purpose in international trade. It reflected the normal business concern that the other party would in fact perform his obligations at the time they were due. If there were serious grounds to conclude that the other party would not perform a substantial part of those obligations, it was appropriate to be allowed to suspend one's own obligations until given adequate assurances that the other party would perform. If the other party would be able to perform as he was obligated to do, it should not be difficult for him to provide the necessary assurances.

402. Most representatives were of the opinion that a decision to suspend performance under article 47 was subject to judicial review as were all cases where the draft Convention gave one party the right to make a determination which affected the contractual relationship. Accordingly, a suggestion to state this principle specifically in article 47 was not retained. It was also noted that should the suspension be unjustified the other party would have recourse to all remedies under the contract and Convention for the suspending party's failure to perform.

403. The Committee, after deliberation, decided to retain article 47.

Paragraph (1)

404. The Committee considered a proposal that article 47 (1) operate only if "it is clear" that the other party would not perform a substantial part of his obligations.

405. In support of this proposal it was stated that the right to suspend a contract should be given only when there was no doubt that a substantial part of the other party's obligations would not be performed.

406. However, under another view it was desirable to have a less rigorous test for suspending performance than the determination that it be "clear" that the other party would not perform a substantial part of his obligations. If it was "clear" that the other party would commit a fundamental breach of contract, the contract could be avoided under article 49.

407. The Committee, after deliberation, decided not to retain this proposal.

Paragraph (2)

408. The Committee considered the following proposals in respect of paragraph (2):

(*a*) That paragraph (2) be deleted;

(*b*) That paragraph (2) also enable the buyer to stop payment of the price.

(a) *Proposal for deletion of paragraph (2)*

409. The proposal to delete paragraph (2) was based on the view that the provision gave an unfair advantage to the seller because the buyer did not have a similar right. Furthermore, it was considered that if the buyer had title to, or property in, the goods the seller should not be able to prevent the buyer from obtaining possession of them.

410. However, it was pointed out that the right of "stoppage in transit" of the goods, as set out in paragraph (2), appears in many legal systems.

411. The Committee decided not to retain the proposal to delete article 47 (2).

(b) *Proposals for extension of principle contained in paragraph (2) to the buyer*

412. The Committee considered a proposal that paragraph (2) be amended to read as follows (italicized words indicate proposed addition to present text):

"(2) If *a party* has already dispatched the goods *or sent the money (including having had issued a letter of credit) for the goods* before the grounds mentioned in paragraph (1) become evident, he may prevent the handing over of the goods *or the payment of the money* even though the *other party* holds a document that entitles him to delivery of the goods *or payment of the money, as the case may be*. This paragraph relates only to rights in the goods *or in the money* as between the buyer and the seller."

413. In support of this proposal, it was stated that it was equitable to extend to the buyer a right to prevent the payment of the money to the seller parallel to the right of the seller to prevent the handing over of the goods to the buyer. It was further stated that, although paragraph (2) could not affect the rights and obligations of third parties, it would enable a party who had sought to prevent the handing over of the goods, or sought to prevent payment of the price, to obtain restitution of those goods or the price. It was noted that this could have important consequences in bankruptcy proceedings.

414. In opposition to this proposal it was stated that article 47 (1) already gave the buyer power to withhold payment of the price or to stop transfer of funds. However, this right should not extend to cases of irrevocable letters of credit or of bills of exchange which had been accepted by the buyer as this would seriously disrupt commercial practice, particularly in relation to documentary sales. It was noted that as a bank has an obligation to pay under an irrevocable letter of credit, the proposed article, which dealt with the rights of only the buyer and the seller, would have no effect but that it might cause confusion in commercial circles. It was also observed that in some countries the stopping of payment of a cheque was a criminal offence. Acceptance of the proposal would make ratification of the Convention difficult in those countries.

415. The Committee, after deliberation, decided not to retain the proposal. It also did not retain a suggestion, designed to overcome the difficulties in relation to letters of credit, that a new paragraph be added to the effect that article 47 (2) "applies to payment provided the goods or part of them have not yet been sent to the buyer when the grounds mentioned in paragraph (1) became evident".

Paragraph (3)

416. The Committee considered a proposal to delete the second sentence of paragraph (3) so that article 47 would be limited to the right to suspend performance. The right to avoid the contract prior to the date for performance would be dealt with under article 49.

417. Support for this proposal was based on the consideration that there may be justifiable differences of opinion on what constitutes "adequate assurance" in a particular case. While this question could, in relation to suspension, be left to the parties, and if necessary to the courts, it was desirable to have a clear rule in relation to the right to declare the contract avoided. This right should not flow automatically from a failure to give "adequate assurance" but should only occur if the conditions of article 49 are satisfied, i.e. if "it is clear that one of the parties will commit a fundamental breach".

418. Opposition to this proposal was based on the view that it was important to be able to terminate the contract if adequate assurance was not given. Any problems as to the meaning of "adequate assurance" could be solved by alternate forms of drafting.

419. The Committee decided to adopt the proposal.

Decision

420. The Committee concludes that the second sentence of paragraph (3) should be deleted so that the right of a party to avoid the contract prior to the date for performance would be governed by article 49. It therefore recommends that the Commission should adopt the following text, now renumbered as article 48:

"Article 48

"(1) A party may suspend the performance of his obligations if it is reasonable to do so because, after the conclusion of the contract, a serious deterioration in the ability to perform or in the creditworthiness of the other party or his conduct in preparing to perform or in actually performing the contract gives good grounds to conclude that the other party will not perform a substantial part of his obligations.

"(2) If the seller has already dispatched the goods before the grounds described in paragraph (1) of this article become evident, he may prevent the handing over of the goods to the buyer even though the buyer holds a document which entitles him to obtain them. This paragraph relates only to the rights in the goods as between the buyer and the seller.

"(3) A party suspending performance, whether before or after dispatch of the goods, must immediately give notice to the other party thereof and must continue with performance if the other party provides adequate assurance of his performance."

ARTICLE 48

421. The text of article 48 as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) If, in the case of a contract for delivery of goods by instalments, the failure of one party to perform any of his obligations in respect of any instalment gives the other party good reason to fear a fundamental breach in respect of future instalments, he may declare the contract avoided for the future, provided that he does so within a reasonable time.

"(2) A buyer, avoiding the contract in respect of future deliveries, may also, provided that he does so at the same time, declare the contract avoided in respect of deliveries already made if, by reason of their interdependence, deliveries already made could not be used for the purpose contemplated by the parties in entering the contract."

Avoidance of the contract in respect of a single instalment

422. The Committee considered a proposal that the following paragraph be added to article 48 as paragraph (1) and that the current paragraphs (1) and (2) be renumbered as paragraphs (2) and (3):

"(1) In the case of a contract for delivery of goods by instalments, if the failure of one party to perform any of his obligations in respect of any instalment constitutes a fundamental breach with respect to that instalment, the other party may declare the contract avoided with respect to that instalment."

423. Support for this proposal was based on the fact that there is no provision enabling the seller to avoid a part of the contract equivalent to article 32 which permits the buyer to do so. It was generally considered that such a provision was useful since, if the buyer's performance is seriously deficient with respect to one instalment, the seller should be permitted to refuse his counter-performance in respect of that instalment even though the failure in respect of that instalment did not give him good reason to fear a fundamental breach in respect of future instalments.

424. However, under another view the right to declare the contract avoided under article 45 (1) (*a*) was sufficient protection for the seller.

425. The Committee adopted the proposal to enable the seller to make partial avoidance of an instalment contract. The Committee also decided to make an appropriate change to the caption to section I of chapter V to reflect this decision.

Paragraph (2)

426. The Committee adopted a proposal which would permit a buyer, who avoids a contract with respect to one delivery, to avoid the contract with respect to other deliveries already made or to be made in the future if the interdependence of that delivery with the deliveries already made or to be made prevents those goods from being used for the purpose contemplated by the parties at the time of the conclusion of the contract.

Decision

427. The Committee concludes that a new paragraph (1) and an amendment to paragraph (2) should be adopted with a consequent change in the caption to section I of chapter V. The Committee recommends that the order of articles 48 and 49 be reversed. It therefore recommends that the Commission should adopt the following text, now renumbered as article 50:

"Article 50

"(1) In the case of a contract for delivery of goods by instalments, if the failure of one party to perform any of his obligations in respect of any instalment constitutes a fundamental breach with respect to that instalment, the other party may declare the contract avoided with respect to that instalment.

"(2) If one party's failure to perform any of his obligations in respect of any instalment gives the other party good grounds to conclude that a fundamental breach will occur with respect to future instalments, he may declare the contract avoided for the future, provided that he does so within a reasonable time.

"(3) A buyer, avoiding the contract in respect of any delivery, may, at the same time, declare the contract avoided in respect of deliveries already made or of future deliveries if, by reason of their interdependence, those deliveries could not be used for the purpose contemplated by the parties at the time of the conclusion of the contract."

ARTICLE 49

428. The text of article 49, as adopted by the Working Group on the International Sale of Goods, is as follows:

"If prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach, the other party may declare the contract avoided."

429. Four representatives indicated that they were of the view that this article should be deleted as it enabled one party to declare the contract avoided unilaterally after that party had concluded that it was "clear" that the other party would commit a fundamental breach. It was stated that it was wrong in principle to allow one party to terminate the contractual relationship unilaterally. This same objection had been raised in relation to other articles of this Convention.

430. A suggestion was also made that article 49 might be merged with article 47. However, the Commission was of the view that article 49 should remain separate from article 47 because it covered, in addition to those cases contemplated by article 47, cases in which it was clear that one party would commit a fundamental breach because of his express refusal to perform or because it was impossible for him to perform.

Decision

431. The Committee concludes that no change in substance is called for in respect of article 49. The Committee recommends that the order of article 48 (now article 50) and article 49 should be reversed. It therefore recommends that the Commission should adopt the following text of article 49:

"Article 49

"If prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach, the other party may declare the contract avoided."

ARTICLE 50

432. The text of article 50, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) If a party has not performed one of his obligations, he is not liable in damages for such non-performance if he proves that it was due to an impediment which occurred without fault on his part. For this purpose there is deemed to be fault unless the non-performing party proves that he could not reasonably have been expected to take into account or to avoid or to overcome the impediment.

"(2) If the non-performance of the seller is due to non-performance by a subcontractor, the seller is exempt from liability only if he is exempt under the provisions of paragraph (1) of this article and if the subcontractor would be so exempt if the provisions of that paragraph were applied to him.

"(3) The exemption provided by this article has effect only for the period during which the impediment existed.

"(4) The non-performing party must notify the other party of the impediment and its effect on his ability to perform. If he fails to do so within a reasonable time after he knew or ought to have known of the impediment, he is liable for the damage resulting from this failure."

433. The Committee discussed generally the most important aspects of article 50 and then referred the formulation of a revised text to a Special Working Group composed of the representatives of the Federal Republic of Germany, Ghana, Mexico, the Philippines, the Union of Soviet Socialist Republics and the United Kingdom.

General discussion of paragraph (1)

Extent of exemption

434. The Committee considered a proposal that the words "in damages" be deleted from the first sentence of paragraph (1). The purpose of this proposal and a number of similar proposals was to extend the exemption provided by article 50 to all obligations of the non-performing party and not merely provide exemption from damages.

435. In support of this proposal it was stated that the exemption from liability for damages may become worthless where the other party can force performance. Therefore, the duty to perform should also be exempted during the period of the impediment. It was also stated that it would be helpful in some common law jurisdictions to make it clear that, in circumstances attracting the operation of article 50, an action requiring performance under the draft Convention would not lie. If this were not done, a court might be constrained to grant an order requiring performance which could cause great difficulty for a non-performing party if he were unable to comply with the court order because of the impediment.

436. However, another view was that the exemption provided by article 50 (1) was rightly limited to damages for if the impediment was of a permanent nature and, if the exemption encompassed all remedies, it would never be possible to avoid the contract. It was also noted that an express exemption from specific performance would lead to the conclusion in some legal systems that there was no breach of contract. As a result the party expecting performance would be unable to declare the contract avoided. Finally, it was observed that it would be undesirable to deal with the question of exemption from the specific performance of the contract in the draft Convention since it would not be possible to also include provisions governing restitution.

437. The Committee, after deliberation, retained the proposal to delete the words "in damages".

Deletion of express reference to "fault"

438. The Committee considered a proposal to delete any express reference to "fault". In support of this proposal it was noted that article 50 provided an exemption from liability to the non-performing party if the non-performance was not due to his "fault". It was also noted that the term "fault" was defined in article 50 in objective terms. Therefore, it would be possible to define the exemption in objective terms without reference to fault.

439. The Committee retained this proposal. At the same time it decided that a party should not be exempt from liability for non-performance if the cause of the non-performance was his own fault. The Committee considered unnecessary a proposal to include a separate paragraph which expressly excluded the operation of paragraph (1) if the impediment was caused by the party seeking exemption. It was thought that the same result could be achieved by providing that the impediment must have been "beyond his control", although some representatives found this phrase vague and considered that it would be difficult to apply in some legal systems.

Non-performance of "one of his obligations"

440. It was proposed that the expression "one of his obligations" be replaced by "his obligations" to indicate that there may be a failure to perform more than one obligation. Support for this proposal was also based on the proposition that this amendment would lead to the desirable conclusion that it would prevent exemption from liability to supply conforming goods. In opposition to this proposal it was stated that exemption should be available for failure to supply conforming goods in appropriate cases.

441. It was also proposed that article 50 (1) be redrafted so that it would not enable a buyer to claim that an impediment beyond his control prevented him from paying the price. In support of this view it was stated that payment of the price is an absolute obligation which it was never legally impossible to perform.

442. However, under another view, it was considered that the article should extend in appropriate cases to inability to pay the price, such as when payment was prohibited by the outbreak of war or the imposition of exchange controls.

443. The Committee did not retain either of these proposals.

Time at which impediment must have been taken into account

444. It was proposed that the phrase "he could not reasonably have taken it into account" be followed by "at the time of the conclusion of the contract" to make it clear the foreseeability of the impediment be judged at the time of the conclusion of the contract.

445. The Committee adopted this proposal.

General discussion of paragraph (2)

446. The Committee considered proposals that paragraph (2) be deleted. Under one view the paragraph was too harsh as it required that the seller, in effect, guarantee the performance of a subcontractor. It was suggested that, at most, the liability of a seller for the fault of a subcontractor appeared to be justified only in cases where the seller could obtain an indemnity from the subcontractor. Another view was that the paragraph was unjustified because the seller's liability for the conformity and delivery of the goods should not be affected by the use of a subcontractor unless a contrary conclusion appeared from the contract.

447. Under another view it was important to retain the uniform rule provided by paragraph (2) rather than leave the question to be determined by national law.

448. The Committee decided to delete the word "subcontractor". The term was said to be unknown in some legal systems and in others to refer primarily to legal relationships in the context of construction contracts. In place of this term the Committee decided to substitute "a person whom [the seller] has engaged to perform the whole or a part of the contract".

449. It was noted that in this manner it would be clear that a seller would not be exempt from liability for failure to perform any of his obligations because of the failure of one of his suppliers to perform since a supplier of the seller could not be considered to be a person the seller had engaged to perform any portion of the seller's contract.

450. The Committee did not retain a suggestion that the seller could avail himself of the exemption only if he had exercised "his own judgement" in selecting the "person whom he has engaged to perform the whole or a part of the contract".

General discussion of paragraph (3)

451. The Committee considered a number of proposals whose objective was to extend the operation of article 50 to impediments which exist for a prolonged period of time. The general approach of these proposals was to enable the contract to be avoided in cases where the impossibility to perform the contract would extend for such a length of time so as radically to change the nature of the obligation to perform. One proposal sought to give this right to the non-performing party while another sought to give it to the party awaiting performance. There was also considerable support to enable both parties to declare the contract avoided in cases of prolonged impossibility of performance.

452. However, under another view the extension of the exemption from performance of contractual obligations to cases of prolonged impossibility of performance was wrong in principle since, although the provision would operate satisfactorily in relation to failures to deliver or failures to take delivery, it would appear to extend also to cases where the impediment had resulted in defects in the goods. It was considered unjust for the seller to be exempt from the obligation to repair or replace defective goods.

453. The Committee decided not to extend to the non-performing party the right to avoid the contract because of a radical change of circumstances during the period of the temporary impediment. However, it was noted that under paragraph (1) of the original text and paragraph (5) of the text as finally adopted by the Committee the party expecting performance would be able to avoid the contract once the delay in performance amounted to a fundamental breach even though the non-performing party was exempted for liability for damages for that breach by virtue of article 50.

Paragraph (4)

454. The Committee decided that the risk of transmission of the notice by the non-performing party should be on that party.

Paragraph (5)

455. The Committee considered that, as a result of its decision to delete the words "in damages" in paragraph (1), it was necessary to insert a new paragraph to state specifically what remedies the party expecting performance retained if the non-performing party was exempted from liability under article 50.

455a. The Committee was in general agreement that the party expecting performance should have the right to avoid the contract if the failure to perform amounted to a fundamental breach. There was also general agreement that he should have the right to reduce the price in appropriate circumstances. However, the Committee was more evenly divided as to whether he should be able to exercise the remedy of specific performance of the contract. Under one view if there was such an impediment that performance was impossible, the law should not purport to give the party expecting performance a right which he could never exercise. Under another view, it could happen that a temporary impediment would cease and at such time a right to specific performance should not be precluded.

456. The Committee decided, after deliberation, that nothing in article 50 prevents either party from exercising any remedy other than damages as a result of the non-performance by the other party.

Decision

457. The Committee therefore recommends that the Commission should adopt the following text, now renumbered as article 51:

"Article 51

"(1) A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be 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.

"(2) If the party's failure is due to the failure by a third person whom he has engaged to perform the whole or a part of the contract, that party is exempt from liability only if he is exempt under paragraph (1) of this article and if the person whom he has engaged would be so exempt if the provisions of that paragraph were applied to him.

"(3) The exemption provided by this article has effect only for the period during which the impediment exists.

"(4) The party who fails to perform must give notice to the other party of the impediment and its effect on his ability to perform. If the notice is not received within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, he is liable for damages resulting from such non-receipt.

"(5) Nothing in this article prevents either party from exercising any right other than to claim damages under this Convention."

PROPOSED ARTICLE ON HARDSHIP

458. The Committee considered a proposal that the following provision be added after article 50:

"If, as a result of special events which occurred after the conclusion of the contract and which could not have been foreseen by the parties, the performance of its stipulations results in excessive difficulties or threatens either party with considerable damage, any party so affected has a right to claim an adequate amendment of the contract or its termination."

459. In support of this proposal it was stated that one of the most important problems for parties to a contract of sale of goods is the problem of changes of circumstances which could not have been foreseen by the parties at the time of the conclusion of the contract. As these changes can result in excessive difficulties for one of the parties it was proposed that the Convention should include a provision enabling any party to renegotiate the conditions of the contract or call for its termination. Such a provision would thus prevent one party from benefiting from windfall gains. It was pointed out that this proposal differed from those made in respect of article 50 (3) in that those proposals presupposed a change in circumstances only during a temporary impediment.

460. The Committee did not retain this proposal.

ARTICLE 51

461. The text of article 51, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) Avoidance of the contract releases both parties from their obligations thereunder, subject to any damages which may be due. Avoidance does not affect provisions for the settlement of disputes.

"(2) If one party has performed the contract either wholly or in part, he may claim from the other party restitution of whatever he has supplied or paid under the contract. If both parties are required to make restitution, they must do so concurrently."

Decision

462. The Committee concludes that no change of substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 52:

"Article 52

"(1) Avoidance of the contract releases both parties from their obligations thereunder, subject to any damages which may be due. Avoidance does not affect any provisions of the contract for the settlement of disputes or any other provisions of the contract governing the respective rights and obligations of the parties consequent upon the avoidance of the contract.

"(2) If one party has performed the contract either wholly or in part, he may claim from the other party restitution of whatever he has supplied or paid under the contract. If both parties are bound to make restitution, they must do so concurrently."

ARTICLE 52

463. The text of article 52, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) The buyer loses his right to declare the contract avoided or to require the seller to deliver substitute goods if it is impossible for him to make restitution of the goods substantially in the condition in which he received them.

"(2) Paragraph (1) of this article does not apply:

(*a*) If the impossibility of making restitution of the goods or of making restitution of the goods substantially in the condition in which he received them is not due to an act of the buyer; or

(*b*) If the goods or part of the goods have perished or deteriorated as a result of the examination provided for in article 22; or

(*c*) If the goods or part of the goods have been sold in the normal course of business or have been consumed or transformed by the buyer in the course of normal use before he discovered the lack of conformity or ought to have discovered it."

Decision

464. The Committee concludes that no change in substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 53:

"Article 53

"(1) The buyer loses his right to declare the contract avoided or to require the seller to deliver substitute goods if it is impossible for him to make restitution of the goods substantially in the condition in which he received them.

"(2) Paragraph (1) of this article does not apply:

"(*a*) if the impossibility of making restitution of the goods or of making restitution of the goods substantially in the condition in which he received them is not due to an act or omission of the buyer; or

"(*b*) if the goods or part of the goods have perished or deteriorated as a result of the examination provided for in article 22; or

"(*c*) if the goods or part of the goods have been sold in the normal course of business or have been consumed or transformed by the buyer in the course of normal use before he discovered the lack of conformity or ought to have discovered it."

ARTICLE 53

465. The text of article 53, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The buyer who has lost the right to declare the contract avoided or to require the seller to deliver substitute goods in accordance with article 52 retains all other remedies."

Decision

466. The Committee concludes that no change in substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 54:

"Article 54

"The buyer who has lost the right to declare the contract avoided or to require the seller to deliver substitute goods in accordance with article 53 retains all other remedies."

ARTICLE 54

467. The text of article 54, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) If the seller is required to refund the price, he must also pay interest thereon, at the rate fixed in accordance with article 58, as from the date on which the price was paid.

"(2) The buyer must account to the seller for all benefits which he has derived from the goods or part of them:

"(*a*) If he must make restitution of the goods or part of them; or

"(*b*) If it is impossible for him to make restitution of all or part of the goods or to make restitution of all or part of the goods substantially in the condition in which he received them, but he has nevertheless declared the contract avoided or required the seller to deliver substitute goods."

468. As a result of its decision to delete article 58 as described in paragraphs 493 to 500 below, the Committee decided to delete ", at the rate fixed in accordance with article 58," from article 54 (1).

Decision

469. The Committee concludes that no change in substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 55:

"Article 55

"(1) If the seller is bound to refund the price, he must also pay interest thereon from the date on which the price was paid.

"(2) The buyer must account to the seller for all benefits which he has derived from the goods or part of them:

"(*a*) if he must make restitution of the goods or part of them; or

"(*b*) if it is impossible for him to make restitution of all or part of the goods or to make restitution of all or part of the goods substantially in the condition in which he received them, but he has nevertheless declared the contract avoided or required the seller to deliver substitute goods."

RELATIONSHIP BETWEEN ARTICLES 55, 56 AND 57

470. Prior to examining the provisions on damages, the Committee considered the relationship between articles 55, 56 and 57.

471. It was generally agreed that articles 56 and 57 were illustrations of the operation of article 55 in particular circumstances. Article 56 dealt with the case where the buyer had bought goods in replacement or the seller had resold the goods. In these situations the measure of damages would be the difference between the contract price and the price in the substitute transaction plus any additional damages, including loss of profit, as might be allowed under article 55. However, if there had not been a substitute transaction and if there was a current price for the goods, the measure of damages would be the difference between the contract price and the current price on the date that the contract was avoided plus any additional damages, including loss of profit, as might be allowed under article 55. In other cases, damages would be calculated according to the general formula in article 55.

472. Furthermore, the Committee was agreed that a party who had in fact arranged a substitute transaction of the nature described in article 56 should not be allowed to claim damages under article 57 where that article would provide for a higher measure of damages.

ARTICLE 55

473. The text of article 55, as adopted by the Working Group on the International Sale of Goods, is as follows:

"Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages cannot exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters which he then knew or ought to have known, as a possible consequence of the breach of contract."

Limit on damages

474. The Committee considered a proposal that the second sentence of article 55 be replaced by the following:

"Such damages shall not include compensation for loss of a nature which the party in breach could not reasonably have foreseen at the time of the conclusion of the contract or of an extent which would be excessive in relation to the price, the ability of the party in breach to foresee or prevent the loss as well as other circumstances of the case."

475. In support of this proposal, it was stated that the present text of article 55 contained a limitation on the amount of damages which was hypothetical and gave little effective guidance in practice. While it would be difficult for a party to foresee the extent of the loss which the other party might suffer as a consequence of the breach, as was now required under article 55, it should not be difficult to foresee the nature of any such loss. However, the damages should also be limited to an amount which would not be excessive in relation to the price, the ability of the party in breach to prevent the loss and "other circumstances of the case."

476. There was little support for this proposal as it was considered to introduce many difficulties, in particular, the determination of whether damages were excessive in relation to the price and the determination of the "other circumstances of the case" which might be relevant. It was further pointed out that, since article 50 provided an exemption from damages if certain conditions were fulfilled, additional criteria in terms of ability to prevent the loss were not appropriate in article 55.

477. The Committee did not retain this proposal.

478. The Committee also did not retain a suggestion that the second sentence of article 55 be deleted so that the question of any limitation on the amount of damages would be left to national law.

Decision

479. The Committee considers that no change of substance is called for in respect of this article. It therefore recommends that the Commission should adopt the following text, now renumbered as article 56:

"Article 56

"Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters which he then knew or ought to have known, as a possible consequence of the breach of contract."

ARTICLE 56

480. The text of article 56, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) If the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may, if he does not rely upon the provisions of articles 55 or 57, recover the difference between the contract price and the price in the substitute transaction.

"(2) Damages under paragraph (1) of this article may include additional loss, including loss of profit, if the conditions of article 55 are satisfied."

481. As noted in paragraph 471 above, the Committee decided that article 56 was an illustration of the general rule of damages set out in article 55. It considered several ways in which this article might be redrafted in order to make this relationship clear.

482. The Committee referred to the Drafting Group a proposal that paragraph (2) be redrafted so as to delete any direct reference to loss of profit since, in the first place it was already referred to in article 55, where it was stated that damages were understood to cover loss of profit, and, in the second place, in such a situation it would be difficult to imagine a loss of profit over and above the difference in prices.

Decision

483. The Committee, therefore, recommends that the Commission should adopt the following text, now renumbered as article 57:

"Article 57

"If the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction and any further damages recoverable under the provisions of article 56."

ARTICLE 57

484. The text of article 57, as approved by the Working Group on the International Sale of Goods, is as follows:

"(1) If the contract is avoided and there is a current price for the goods, the party claiming damages may, if he does not rely upon the provisions of articles 55 or 56, recover the difference between the price fixed by the contract and the current price on the date on which the contract is avoided.

"(2) In calculating the amount of damages under paragraph (1) of this article, the current price to be taken into account is the price prevailing at the place where delivery of the goods should have been made or, if there is no current price at that place, the price at another place which serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods.

"(3) Damages under paragraph (1) of this article may include additional loss, including loss of profit, if the conditions of article 55 are satisfied."

Paragraph (1)

Relevant date for determination of current price

485. The Committee considered a proposal that damages under paragraph (1) be based on the current price on the date delivery was performed or ought to have been performed.

486. Support for this proposal was based on the view that calculating the current price on the date that the contract was avoided would permit a party to speculate on whether his damages would increase because of future price changes if he were to delay the date on which he declared the contract avoided.

487. However, another view was that this proposal could cause difficulties in practice, particularly in cases of non-performance where there was no fixed delivery date but delivery was to be made within a fixed period pursuant to article

17 (b) or within a reasonable time after the conclusion of the contract pursuant to article 17 (c). It was also noted that the proposed new method of calculation of current price might still permit speculation. In any case, any abuses of the method of calculating damages under this article would be dealt with by the principle of mitigation of damages contained in article 59.

488. The Committee decided not to retain the proposal to base the calculation of damages on the current price on the date delivery was performed or ought to have been performed. However, in view of the difficulties which were expressed in relation to the current text the Committee decided to adopt a compromise proposal that the current price be calculated on the day on which the party first had the right to declare the contract avoided. Although it was stated that this test might encourage the seller to avoid the contract before he otherwise would, the general view was that this test selected a sufficiently clear and objective date for the calculation of the current price and one which did not encourage the party claiming damages to speculate on the future price level.

Paragraphs (2) and (3)

489. As noted in paragraph 471 above, the Committee decided that article 57 was an illustration of the general rule of damages set out in article 55. It also decided that a party who had in fact arranged a substitute transaction of the nature described in article 56 should not be allowed to claim damages under article 57 where that article would provide for a higher measure of damages.

490. The Committee referred to the Drafting Group the same proposal in respect of article 57 (3) as is described in paragraph 482 above in respect of article 56 (2).

Decision

491. The Committee recommends that the Commission should adopt the following text, now renumbered as article 58:

"Article 58

"(1) If the contract is avoided and there is a current price for the goods, the party claiming damages may, if he has not made a purchase or resale under article 57, recover the difference between the price fixed by the contract and the current price at the time he first had the right to declare the contract avoided and any further damages recoverable under the provisions of article 56.

"(2) For the purposes of paragraph (1) of this article, the current price is the price prevailing at the place where delivery of the goods should have been made or, if there is no current price at that place, the price at another place which serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods."

ARTICLE 58

492. The text of article 58, as adopted by the Working Group on the International Sale of Goods, is as follows:

"If the breach of contract consists of delay in the payment of the price, the seller is in any event entitled to interest on such sum as is in arrears at a rate equal to the official discount rate in the country where he has his place of business, plus 1 per cent, but his entitlement is not to be lower than the rate applied to unsecured short-term commercial credits in the country where the seller has his place of business."

Place at which interest should be calculated

493. The Committee considered a proposal that the place at which interest should be calculated should be the buyer's country. It was stated that if the rate of interest in the seller's country was significantly lower than the rate of interest in the buyer's country, the buyer might be tempted to delay payment so as to take advantage of this favourable rate. Alternatively, it was suggested that the rate might be based upon the average of the rate in the buyer's country and the rate in the seller's country.

494. In opposition to this proposal it was stated that, if the buyer did not pay the price when due and the seller had to borrow money because of the late payment, he would normally have to borrow in his own country at the prevailing rates there. Even if he did not have to borrow money as a result of the late payment, he would have less money on deposit in his own country gaining interest. If the prevailing rate of interest in his country was 15 per cent but it was only 6 per cent in the buyer's country, it would not be appropriate for him to be limited to the lower interest rate in the buyer's country.

Proposals to delete article 58 or to make a declaration or reservation

495. The discussions in respect of the place at which the interest should be calculated brought forth a number of proposals whose objective was the deletion of article 58 or the possibility of rendering it inoperative in relation to individual States, either by means of reservation or by means of declaration.

496. These proposals arose from the fact that many countries had mandatory rules of public policy prohibiting interest rates to exceed a specified maximum, frequently of the order of 6 to 7 per cent. Furthermore, some countries prohibited the charging of any interest whatsoever. A provision along the lines of article 58, which would require the charging of interest and its calculation at a rate which might be far in excess of that usual or allowed in the buyer's country, the place at which any judicial procedure for late payment would normally take place, would make it difficult for some countries to adhere to the Convention.

497. There was general sympathy expressed for those countries whose national laws set maximum rates of interest which could conflict with the rate produced by the formula in article 58. It was noted that article 58 contained a particular method of assessing damages which, although it was convenient in practice, was not essential. Loss suffered by a seller due to delay in payment of the price could be recovered under the general formula for recovery of damages expressed in article 55.

498. In addition, apart from many drafting problems, the following matters would require clarification if the article was retained:

(*a*) Article 58 referred to an "official discount rate" but many countries did not have an "official discount rate";

(*b*) Article 58 referred to "the rate applied to unsecured short-term commercial credits" but there was usually no one such rate since the rate would vary depending on the parties or the nature of the sale;

(*c*) The addition of "one per cent" to the "official discount rate" was considered by some representatives to be unjust.

499. In view of these difficulties, coupled with the fact that the article was, in any version, inherently unacceptable to a number of representatives, particularly those of developing countries, the Committee, after considerable deliberation, decided to delete article 58.

Decision

500. The Committee recommends that the Commission should delete article 58.

ARTICLE 59

501. The text of article 59, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The party who relies on a breach of contract must adopt such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to adopt such measures, the party in breach may claim a reduction in the damages in the amount which should have been mitigated."

Right to recover the price

502. The Committee considered a proposal that the second sentence of article 59 read as follows (the proposed additional words are in italics):

"If he fails to adopt such measures, the party in breach may claim a reduction in the damages, *including any claim for the price,* in the amount which should have been mitigated."

503. In support of this proposal it was stated if the seller was in breach, the buyer's duty to mitigate the damages might encompass the purchase of substitute goods. However, under the present text of article 59 it would appear that if the buyer was in breach, the seller could maintain an action for the price even if he could have sold the goods elsewhere. The proposal was designed to ensure that in such cases the seller's right of recovery would be limited to the amount recoverable under article 57.

504. However, there was considerable opposition to this proposal which was considered to permit a defaulting buyer to prevent payment of the purchase price by showing that the seller could have sold goods elsewhere. This would destroy the distinction between an action for the price and an action for damages, a distinction which was fundamental in many legal systems. The price was agreed upon by the parties and if the contract was still in existence, the seller must have the right to sue for the price. There was no duty on the seller to seek, or accept, from a third party a price lower than that agreed upon with the buyer even if he might then recover the difference from the buyer.

505. The Committee, after deliberation, decided not to retain the proposal extending the principle of mitigation to actions for the price.

Duty to notify

506. The Committee did not retain a proposal that article 59 specifically provide that part of the duty to mitigate should be that the injured party give notice of the breach to the party in breach, within a reasonable time of its occurrence.

Decision

507. The Committee concludes that no change of substance is called for in respect of article 59. It therefore recommends that the Commission should adopt the following text:

"Article 59

"The party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount which should have been mitigated."

PROPOSED ARTICLE ON FRAUD

508. The Committee considered a proposal to review the decision of the Working Group on the International Sale of Goods which had deleted article 89 of ULIS (which provided that in case of fraud, the determination of damages was to be made by reference to national law).

509. This proposal did not attract sufficient support to be discussed in detail.

PROPOSED ARTICLE ON LIQUIDATED DAMAGES

510. The Committee considered a proposal that the Convention include a provision on liquidated damage clauses in contracts of sale. The following text was proposed as a basis for discussion:

"(1) The parties may agree in the contract or otherwise that a party who breaches the contract in a particular manner will pay liquidated damages to the other party.

"(2) Unless otherwise agreed upon by the parties, the payment of liquidated damages may be asked together with the request for the performance of the contract.

"(3) The judge or arbitrator may, on the request of the party required to pay, reduce the amount of liquidated damages if the other party contributed to the loss or did not co-operate in the performance of the contract where such co-operation was [needed] under the circumstances of the case.

"(4) The other party may claim, instead of the liquidated damages agreed upon in the contract, damages according to article 55 if the loss sustained by him is substantially higher than the damages agreed upon in the contract."

511. In support of this proposal, it was stated that the Convention should contain a provision on liquidated damage clauses because this type of contractual clause was widely used in international commerce. Since the rules governing liquidated damage clauses vary between legal systems it would be a practical contribution to international trade to establish a uniform régime governing these types of contractual clauses. It was noted that the proposed article was intended to initiate discussion along these lines.

512. After a brief review of the main features of the draft article, which revealed a number of technical problems, it became apparent that there was considerable support for the idea behind the proposal i.e. that uniform rules regulating liquidated damage clauses would be an important contribution to the facilitation of international trade and commerce. However, it was generally considered that establishing a unified régime to regulate liquidated damage clauses was a complex problem which warranted more attention than could be given at this stage of the deliberations in respect of this draft Convention. Furthemore, liquidated damage clauses were also important in many types of contracts which fell outside the scope of the Convention. For all these reasons it would be preferable to deal with the liquidated damage clauses in a separate instrument which could be applied to all types of international contracts and not be restricted to international contracts for the sale of goods.

Decision

513. The Committee, after deliberation, recommends to the Commission that it request the Secretary-General to consider, as part of the study on the future long-term programme of work of the Commission which is to be presented at the eleventh session of the Commission, the feasibility and desirability of establishing a uniform régime governing liquidated damage clauses in international contracts.

ARTICLE 60

514. The text of article 60, as adopted by the Working Group on the International Sale of Goods, is as follows:

"If the buyer is in delay in taking delivery of the goods and the seller is either in possession of the goods or otherwise able to control their disposition, the seller must take such steps as are reasonable in the circumstances to preserve them. He may retain them until he has been reimbursed his reasonable expenses by the buyer."

Decision

515. The Committee concludes that no change of substance is called for in respect of article 60. It therefore recommends that the Commission should adopt the following text:

"Article 60

"If the buyer is in delay in taking delivery of the goods and the seller is either in possession of the goods or otherwise able to control their disposition, the seller must take such steps as are reasonable in the circumstances to preserve them. He may retain them until he has been reimbursed his reasonable expenses by the buyer."

ARTICLE 61

516. The text of article 61, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) If the goods have been received by the buyer and he intends to reject them he must take such steps as are reasonable in the circumstances to preserve them. He may retain them until he has been reimbursed his reasonable expenses by the seller.

"(2) If goods dispatched to the buyer have been put at his disposal at the place of destination and he exercises the right to reject them, he must take possession of them on behalf of the seller, provided that he can do so without payment of the price and without unreasonable inconvenience or unreasonable expense. This provision does not apply if the seller or a person authorized to take charge of the goods on his behalf is present at the destination."

Decision

517. The Committee concludes that no change of substance is called for in respect of article 61. It therefore recommends that the Commission should adopt the following text:

"Article 61

"(1) If the goods have been received by the buyer and he intends to reject them, he must take such steps as are reasonable in the circumstances to preserve them. He may retain them until he has been reimbursed his reasonable expenses by the seller.

"(2) If goods dispatched to the buyer have been placed at his disposal at their destination and he exercises the right to reject them, he must take possession of them on behalf of the seller, provided that he can do so without payment of the price and without unreasonable inconvenience or unreasonable expense. This provision does not apply if the seller or a person authorized to take charge of the goods on his behalf is present at the destination."

ARTICLE 62

518. The text of article 62, as adopted by the Working Group on the International Sale of Goods, is as follows:

"The party who is under an obligation to take steps to preserve the goods may deposit them in a warehouse of a third person at the expense of the other party provided that the expense incurred is not unreasonable."

Decision

519. The Committee considers that no change of substance is called for in respect of article 62. It therefore recommends that the Commission should adopt the following text:

"Article 62

"The party who is bound to take steps to preserve the goods may deposit them in a warehouse of a third person at the expense of the other party provided that the expense incurred is not unreasonable."

ARTICLE 63

520. The text of article 63, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) If there has been an unreasonable delay by the other party in taking possession of the goods or in taking them back or in paying the cost of preservation and notice of his intention to sell has been given, the party who is under an obligation to preserve the goods in accordance with articles 60 or 61 may sell them by any appropriate means.

"(2) If the goods are subject to loss or rapid deterioration or their preservation would involve unreasonable expense, the party who is under an obligation to preserve the goods in accordance with articles 60 or 61 must take reasonable efforts to sell them. To the extent possible he must give notice of his intention to sell.

"(3) The party selling the goods has the right to retain out of the proceeds of sale an amount equal to the reasonable costs of preserving the goods and of selling them. He must account to the other party for the balance."

Paragraph (1)

521. The Committee did not retain a proposal to add a sentence to paragraph (1) to the effect that a seller under an obligation to preserve the goods in accordance with article 60 "must make reasonable efforts to resell the goods if the buyer so requests".

Decision

522. The Committee concludes that no change in substance is called for in respect of article 63. It therefore recommends that the Commission should adopt the following text:

"Article 63

"(1) The party who is bound to preserve the goods in accordance with articles 60 or 61 may sell them by any appropriate means if there has been an unreasonable delay by the other party in taking possession of the goods or in taking them back or in paying the cost of preservation, provided that notice of the intention to sell has been given to the other party.

"(2) If the goods are subject to loss or rapid deterioration or their preservation would involve unreasonable expense, the party who is bound to preserve the goods in accordance with articles 60 or 61 must take reasonable measures to sell them. To the extent possible he must give notice to the other party of his intention to sell.

"(3) The party selling the goods has the right to retain out of the proceeds of sale an amount equal to the reasonable expenses of preserving the goods and of selling them. He must account to the other party for the balance."

ARTICLE 64

523. The text of article 64, as adopted by the Working Group on the International Sale of Goods, is as follows:

"If the risk has passed to the buyer, he must pay the price notwithstanding loss of or damage to the goods, unless the loss or damage is due to an act of the seller."

General rule on passage of risk

524. The view was expressed that the first part of article 64, which stated a general rule on the passage of risk, should be deleted as it merely stated the self-evident proposition that once the risk had passed to the buyer he must bear the risk of loss or damage to the goods.

525. However, there was considerable support for the retention of the first part of article 64 as it, together with articles 65 to 67, provided a uniform rule for the passage of risk. It was noted that this was important since the rules on risk of loss varied in different legal systems.

526. The Committee decided to retain the general rule on the passage of risk.

Exception to the general rule on passage of risk

527. It was proposed that the second part of the article should be deleted as it was too much of a simplification to be helpful and could be misinterpreted to mean that the buyer did not have to pay the price if there was a fault or defect in the goods.

528. In opposition to this proposal, it was argued that the exception stated in the second part of article 64 was of great importance since, even though the risk had passed, the seller could still interfere with the goods in such a manner as to cause loss. The second part of the article made it clear that the buyer

would not have to pay the price to the extent that loss or damage to the goods had been caused by such an act of the seller.

529. The proposal to delete the second part of article 64 was withdrawn.

530. The Committee decided that the text should make it clear that an omission to perform an act which resulted in loss or damage had the same consequences as the Commission of an act which resulted in loss or damage.

531. The Committee also considered a proposal that the exception to the general rule should operate only if the act or omission on the part of the seller amounted to a breach of contract. In opposition to this proposal it was pointed out that the seller might act in a manner which was not a breach of contract but might still cause damage, e.g. if in an f.o.b. contract the seller removed his containers after the goods had been unloaded and, in so doing, damaged the goods.

532. The Committee did not retain this proposal.

Decision

533. The Committee concludes that no change in substance is called for in respect of article 64. It therefore recommends that the Commission should adopt the following text:

"Article 64

"Loss or damage to the goods after the risk has passed to the buyer, does not discharge him from his obligation to pay the price, unless the loss or damage is due to an act or omission of the seller."

ARTICLE 65

534. The text of article 65, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) If the contract of sale involves carriage of the goods and the seller is not required to hand them over at a particular destination, the risk passes to the buyer when the goods are handed over to the first carrier for transmission to the buyer.

"(2) If at the time of the conclusion of the contract the goods are already in transit, the risk passes as from the time the goods were handed over to the first carrier. However, the risk of loss of goods sold in transit does not pass to the buyer if, at the time of the conclusion of the contract, the seller knew or ought to have known that the goods had been lost or damaged, unless the seller had disclosed such fact to the buyer."

Exception to rule in paragraph (1)

535. The Committee considered a proposal that the following sentence be added to paragraph (1):

"However, if the seller is required to hand the goods over to the carrier at a particular place, the risk does not pass to the buyer before the goods are handed over to the carrier at this place."

536. In support of this proposal it was stated that paragraph (1) did not give a reasonable solution in cases where the seller undertook to ship the goods from a particular place at an inland point. In such a situation the risk should pass to the buyer only when the goods were handed over to a carrier at a seaport and not when they are handed over to a domestic carrier for transport to the seaport.

537. There was considerable support for this proposal and the Committee, after having accepted certain modifications which related to drafting, retained the proposal.

Control of documents

538. The Committee considered a proposal designed to make it clear that the seller's retention of control of the goods by retaining the documents as security against payment until after the goods are shipped does not affect the passage of risk. The proposal was as follows:

"The fact that the seller is authorized to retain documents controlling the disposition of the goods does not affect the passage of risk."

539. The Committee, after deliberation, adopted the proposal.

Paragraph (2)

540. The Committee considered a proposal under which the risk in respect of goods sold in transit would not pass on shipment if the shipment was of unascertained or unidentified goods for transmission to various consignees. This proposal was opposed on the ground that it would unnecessarily limit the scope of paragraph (2).

541. The Committee after deliberation retained the text of paragraph (2) as proposed by the Working Group on the International Sale of Goods.

542. The representative of the Philippines expressed a reservation in respect of the second sentence of paragraph (2) in that the provisions of that paragraph were not consistent with logic. It was stated that it was inconceivable that the buyer should bear the risk of loss or damage to the goods prior to the time that the contract was concluded. Although the view had been expressed in the Committee that the paragraph accorded with international commercial practice, that practice was one of the developed world. UNCITRAL should take into account the resolutions of the General Assembly which laid down the framework of a new international economic order. If UNCITRAL wished to carry out its mandate to make ULIS more acceptable to countries of widely different economic and social backgrounds it should not ignore these General Assembly resolutions.

543. However, the representative of Finland pointed out that the draft Convention contained non-mandatory rules. No buyer had to purchase goods afloat and if he did so the price paid for such goods would reflect the added risk. The view was also expressed that the rule set forth in paragraph (2) was the result of practical needs. If, in the case at issue, the goods had been damaged during the carriage it was not always possible to determine at what moment they had been damaged. If there was no indication on the bill of lading the buyer-consignee could claim damages from the carrier and would also be covered by the insurance policy in respect of the goods.

New paragraph (3)

544. The Committee considered a proposal that a new paragraph (3) be added to article 65 to read as follows:

"(3) If the goods are not identified for delivery to the buyer, by marking with an address or otherwise, they are not clearly identified to the contract unless the seller gives notice of the consignment and, if necessary, sends some documents specifying the goods."

545. The Committee retained this proposal.

Decision

546. The Committee, having regard to the decisions recorded in the previous paragraphs recommends that the Commission should adopt the following text:[h]

"Article 65

"(1) If the contract of sale involves carriage of the goods and the seller is not required to hand them over at a particular destination, the risk passes to the buyer when the goods are handed over to the first carrier for transmission to the buyer. If the seller is required to hand the goods over to a carrier at a particular place other than the destination, the risk does not pass to the buyer until the goods are handed over to the carrier at that place. The fact that the seller is authorized to retain documents controlling the disposition of the goods does not affect the passage of risk.

[h] The Drafting Group concluded that, for reasons of clarity, article 65 (2) be contained in a separate article and be renumbered as article 66.

"(2) Nevertheless, if the goods are not clearly marked with an address or otherwise identified to the contract, the risk does not pass to the buyer until the seller sends the buyer a notice of the consignment which specifies the goods.

"Article 66

"The risk in respect of goods sold in transit is assumed by the buyer from the time the goods were handed over to the carrier who issued the documents controlling their disposition. However, if at the time of the conclusion of the contract the seller knew or ought to have known that the goods had been lost or damaged and he has not disclosed such fact to the buyer, such loss or damage is at the risk of the seller."

ARTICLE 66

547. The text of article 66, as adopted by the Working Group on the International Sale of Goods, is as follows:

"(1) In cases not covered by article 65 the risk passes to the buyer as from the time when the goods were placed at his disposal and taken over by him.

"(2) If the goods have been placed at the disposal of the buyer but they have not been taken over by him or have been taken over belatedly by him and this fact constitutes a breach of the contract, the risk passes to the buyer at the last moment he could have taken over the goods without committing a breach of the contract. If the contract relates to the sale of goods not then identified, the goods are deemed not to be placed at the disposal of the buyer until they have been clearly identified to the contract."

Paragraph (1)

548. The Committee referred to the Drafting Group a proposal which had as its purpose to distinguish between the occasions on which the risk of loss would pass when the goods were taken over by the buyer and the occasions on which the risk of loss would pass as a consequence of the goods having been placed at his disposal.

549. The Committee did not retain a proposal designed to specify that, if the terms of delivery of a contract called for the seller to place the goods at the disposal of the buyer during a specified period of time, the risk of loss should pass at the time when the goods were placed at the buyer's disposal and not when they were actually taken over by him.

Paragraph (2)

550. The Committee considered a proposal that paragraph (2) read as follows:

"(2) If, however, the buyer is required to take over the goods at a place other than any place of business of the seller, the risk passes when the time for delivery has come and the buyer is aware, or has received notice, of the fact that the goods are placed at his disposal at such place."

551. In support of this proposal it was stated that paragraph (2) would govern the time at which the risk passes where the goods are at a place other than a place of business of the seller, such as a public warehouse. In some legal systems the taking over of the goods from a public warehouse may be done by the handing over of a negotiable document of title or the acknowledgement by the third person that he holds the goods for the benefit of the buyer. However, this result did not necessarily follow from the present text. In addition, differences in national laws as to documents of title and warehouse receipts made unification in this area difficult. Accordingly the proposal would resolve uncertainty by emphasizing physical delivery of the goods but in addition permitting risk to pass when the time for delivery had come and the buyer was aware, or had received notice, of the fact that the goods had been placed at his disposal at a place other than the place of the seller.

552. After deliberation, the Committee adopted this proposal in principle.

Decision

553. The Committee, in the light of the decisions discussed in the above paragraphs, recommends that the Commission should adopt the following text, now renumbered as article 67:

"Article 67

"(1) In cases not covered by articles 65 and 66 the risk passes to the buyer when the goods are taken over by him or, if he does not do so in due time, from the time when the goods are placed at his disposal and he commits a breach of contract by failing to take delivery.

"(2) If, however, the buyer is required to take over the goods at a place other than any place of business of the seller, the risk passes when delivery is due and the buyer is aware of the fact that the goods are placed at his disposal at that place.

"(3) If the contract relates to a sale of goods not then identified, the goods are deemed not to be placed at the disposal of the buyer until they have been clearly identified to the contract."

ARTICLE 67

554. The text of article 67, as adopted by the Working Group on the International Sale of Goods, is as follows:

"If the seller has committed a fundamental breach of contract, the provisions of articles 65 and 66 do not impair the remedies available to the buyer on account of such breach."

555. The Committee adopted a proposal to extend the operation of article 67 to all cases where the buyer has a right to declare the contract avoided rather than restricting it to cases where there has been a fundamental breach of contract. In particular, article 67 will operate when the conditions of articles 30 (1) (*b*), 45 (1) (*b*) and article 49 are satisfied.

Decision

556. The Committee recommends that the Commission should adopt the following text, now renumbered as article 68:

"Article 68

"If the seller has committed a fundamental breach of contract, the provisions of articles 65, 66 and 67 do not impair the remedies available to the buyer on account of such breach."

FINAL CLAUSES

557. The Committee had before it a report of the Secretary-General on draft final clauses (A/CN.9/135) prepared by the secretariat in response to a request made to it by the Working Group on the International Sale of Goods.

558. The Committee was agreed that, with the exception of the declaration to article 11 (see para. 134 above), the final clauses were a matter for the conference of plenipotentiaries and that the Commission should not officially comment on the suitability or on the substance of the draft final clauses.

559. However, the Committee held a brief preliminary discussion of the final clauses so that the secretariat could take account of any views expressed by representatives or observers when submitting draft final clauses to the conference. In particular, the Committee requested the secretariat to take note of the two following proposals:

(*a*) "This Convention shall not prevail over conventions already entered into or which may be entered into, and which contain provisions concerning the matters covered by this Convention, provided that the seller and buyer have their places of business in States parties to such a convention."

(*b*) "(1) A Contracting State may at any time declare that contracts of sale between a seller having a place of business in that State and a buyer having a place of business in another State shall not be governed by this Convention, because

the two States apply to the matters governed by this Convention the same or closely related legal rules.

"(2) If that other State is a Contracting State, such declarations must be made jointly by the two Contracting States or by reciprocal unilateral declarations."

560. The Committee therefore recommends that the Commission should request the Secretary-General to prepare draft final clauses for the consideration of the conference of plenipotentiaries which the General Assembly may wish to convene. The Committee also recommends that the Commission request the secretariat to invite federal and non-unitary States to indicate their views on the desirability of a federal State clause in the Convention on the International Sale of Goods. The representative of Australia indicated his reservation on this point.

Form of rules contained in the draft Convention

561. The Committee took note of the statement of a representative that he would recommend to the Commission that the rules contained in the draft Convention on the International Sale of Goods be formulated as uniform rules for optional use by the parties to a sales transaction rather than in the form of a Convention.[1]

[1] See paras. 20-32 of the report of the Commission.

ANNEX II

Report of Committee of the Whole II

INTRODUCTION

1. The Committee of the Whole II was established by the Commission at its 180th meeting, on 23 May 1977. The Committee met on 6, 7 and 9 June 1977 and held five meetings. The Committee, at its first meeting on 6 June 1977, elected Mr. Roland Loewe (Austria) as Chairman and Mr. Clement O. Magreola (Nigeria) as Rapporteur.

2. The Commission, at its 180th meeting, referred to the Committee the following items on its agenda:

Item 4 International sale of goods: general conditions of sale.

Item 5 International payments:
(*a*) Security interests in goods;
(*b*) Negotiable instruments.

Item 6 International commercial arbitration.

Item 7 Liability for damage caused by products intended for or involved in international trade.

Item 8 Training and assistance in the field of international trade law.

Item 10 Other business: consistency of legal provisions drafted by the Commission and its Working Groups.

3. The Committee adopted this report at its fifth meeting, on 9 June 1977.

CHAPTER I

INTERNATIONAL SALE OF GOODS

General conditions of sale and standard contracts

4. At its eighth session, the Commission requested the Secretary-General to make inquiries about the practical need for "general" general conditions for use in a wide variety of trades and to report to the Commission at a future session on the progress made in respect of this project.[a] The Committee had before it a report of the Secretary-General on "General conditions of sale and standard contracts" (A/CN.9/136). This report contains an account of the discussions of a meeting of experts which the Secretariat had arranged with the International Chamber of Commerce (ICC) on 16 December 1976.

5. The Committee took note of the report of the Secretary-General. The Committee was informed of the work programmes of ICC and of the Asian-African Legal Consultative Committee in respect of this subject.

6. The observer of ICC stated that his organization was now carrying out work on standard terms and clauses rather than "general" general conditions. It had recently been decided to revise those standard clauses, like the Incoterms, which already provided a certain degree of uniform practice. Also, a working group had been established to elaborate new standard terms such as the *force majeure* clause. The observer expressed the interest of his organization to obtain views and suggestions on both projects, particularly by States not represented in ICC, and thus would welcome the co-operation of the Commission.

7. The Observer of the Asian-African Legal Consultative Committee stated that his organization had identified certain categories of goods for which uniform contract conditions seemed particularly useful. For these types of goods, it had elaborated several standard contracts, with the assistance of the secretariat of the Commission and of the Economic Commission for Europe.

Decision of the Committee

8. The Committee decided to recommend that the Commission should adopt the following decision:

[*The text is not reproduced; for the decision as adopted by the Commission, see paragraph 36 of the Commission's report, above.*]

CHAPTER II

INTERNATIONAL PAYMENTS

A. *Security interests in goods*

9. The Committee had before it a study on security interests (A/CN.9/131),* a note of the Secretariat in respect of article 9 of the Uniform Commercial Code of the United States of America (A/CN.9/132)* and a report of the Secretary-General (A/CN.9/130), containing a general survey of the existing law on security interests, proposals for reform and the conclusions reached by a consultative group convened jointly by the secretariat of the Commission and the International Chamber of Commerce on 14 and 15 December 1976.

10. The Committee was generally agreed that, in view of the practical importance of security interests to international trade, the secretariat should be requested to continue work on the subject. The creation of a security interest that would be recognized and enforceable outside the country where it was created would enlarge the pool of credit available for international trade. However, the view was also expressed that the difficulties that would be encountered in establishing a scheme of uniform rules would be too formidable and that the chances of a successful conclusion of the work would therefore be slight. In this connexion, reference was made to the great differences in the law of security interests in the countries of the world and, in particular, to the impossibility of unifying national bankruptcy laws (of great relevance in the area of security interests) and the difficulty of establishing registration or filing systems. The question was also raised whether the alternatives of insurance and guarantee, in particular export finance insurance, would not provide an easier solution to the purported aim of enlarging the quantity of credit available for international trade.

11. The discussions in the Committee, after this exchange of views on the feasibility of establishing uniform rules, focused on three possible techniques of harmonization:

(*a*) Preparation of rules on conflict of laws,

(*b*) Creation of substantive rules that would apply only to international transactions;

[a] *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17* (A/10017), para. 25 (Yearbook ..., 1975, part one, II, A).

*Reproduced in part two of this volume.

(c) Unification of the national laws on security interests by means of a uniform law applicable both to national and to international transactions.

12. The technique of preparing rules on conflict of laws found little support in the Committee on the ground that it would not modernize the law so as to meet the needs of international commerce and would thus perpetuate the present inadequate situation.

13. There was some support for the creation of an additional security interest that would be used primarily in international transactions but could also be used domestically. According to another view, one or two specific widely known security interests should be selected, such as for instance the conditional sale, with a view to creating uniform rules applicable on universal level. Yet another view was that uniform rules should be confined, for the sake of simplicity of registration, to large items such as ships and aircraft.

14. There was considerable support in the Committee for further study of the third method, i.e. the creation of a new security interest, based on a functional approach, that would apply to domestic as well as international transactions. The view was expressed that work should not be directed towards the elaboration of draft rules, but that the Secretariat should instead attempt to determine whether a uniform scheme was needed in practice and would be in the interest of international trade, bearing in mind that such a scheme would imply a radical change in national laws, even as regards exclusively internal relations. It was further suggested that the work on security interests should be reconsidered in the context of the future programme of work of the Commission, to be discussed at the Commission's eleventh session.

15. The Committee was informed of the current programme of work of the European Economic Community and of the International Chamber of Commerce in respect of security interests. The observers of both organizations expressed their willingness to co-operate with the Commission in the work on this subject.

Decision of the Committee

16. The Committee, after deliberation, decided to recommend to the Commission that it adopt the following decision:

[The text is not reproduced; for the decision as adopted by the Commission, see paragraph 37 of the Commission's report, above.]

B. *Negotiable instruments*

17. The Committee was informed of the progress made by the Working Group on International Negotiable Instruments.

C. *Contract guarantees*

18. At its eighth session, the Commission took note of the work of the International Chamber of Commerce (ICC) in respect of the preparation of uniform rules on contract guarantees and invited this organization to submit progress reports to the Commission at further sessions.[b]

19. The Committee was informed of the work undertaken by ICC. The observer of ICC emphasized the importance of the contribution of the Commission and its secretariat to the work of ICC on this subject. He stated that draft rules had been worked out by a Study Group and examined by two commissions of his organization. He expressed the view that, taking into account the information provided by the Commission, merely one important problem remained to be solved, namely, that of guarantees payable on first demand which are not included in the draft rules.

20. The observer of ICC informed the Committee that a Study Group would consider, on 26 and 27 June 1977, the observations of Governments on the draft rules and prepare a final text that would take account of these observations.

Decision of the Committee

21. The Committee decided to recommend to the Commission to review the item of contract guarantees at its eleventh session when the work of the International Chamber of Commerce on uniform rules on contract guarantees will be concluded.

CHAPTER III

INTERNATIONAL COMMERCIAL ARBITRATION

A. *UNCITRAL Arbitration Rules*

22. The Committee took note of General Assembly resolution 31/98 of 15 December 1976 on the Arbitration Rules of the United Nations Commission on International Trade Law by which the Assembly recommended the use of the UNCITRAL Arbitration Rules in the settlement of disputes arising in the context of international commercial relations, particularly by reference to the Arbitration Rules in commercial contracts.

23. The Committee noted that the report of the Sixth Committee of the General Assembly on the report of the United Nations Commission on International Trade Law on the work of its ninth session recorded that "commenting on the UNCITRAL Arbitration Rules themselves, many delegates expressed satisfaction with their optional character. It was noted with approval that the Rules had been produced by the Commission, not in the usual form of a draft convention, but in the much simpler and less costly form of model rules for parties, requiring no international convention or national legislative enactment" and that it had been suggested that "this was a method which the Commission might possibly wish to employ with respect to its future projects, whenever appropriate."[c]

24. The Committee took note with satisfaction of the favourable reception of the UNCITRAL Arbitration Rules in various parts of the world. The Asian-African Legal Consultative Committee, at its seventeenth session at Kuala Lumpur, Malaysia, held in 1976, had recommended the use of the UNCITRAL Arbitration Rules in the settlement of disputes arising in the context of international commercial relations, and had included an arbitration clause referring to the UNCITRAL Arbitration Rules in certain of its standard form contracts, notably its "Standard Form FOB Contract".

25. It was also reported that it was barely a year since the UNCITRAL Arbitration Rules had been adopted by the Commission and less than six months since the General Assembly had recommended their use, yet in that short span of time the Rules had been accepted in a number of significant contexts. For example, a new model arbitration clause prepared by the USSR Chamber of Commerce and Industry and the American Arbitration Association for optional use in contracts between corporations in the United States of America and foreign trade organizations in the Soviet Union provided for proceedings to be conducted under the UNCITRAL Arbitration Rules. Also, the Inter-American Commercial Arbitration Commission, a body established by the Organization of American States, had amended its rules of procedure, effective 1 January 1978, so that those rules will substantially incorporate the UNCITRAL Arbitration Rules. The London Court of Arbitration, the Stockholm Chamber of Commerce and the American Arbitration Association were among the arbitration centres which had announced that they will act as appointing authorities and provide administrative services in cases conducted under the UNCITRAL Arbitration Rules.

B. *Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 1958*

26. The Committee recalled that the Commission, at its sixth session, had recommended that the General Assembly should in-

[b] *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17* (A/10017), para. 46 (Yearbook . . . , 1975, part one, II, A).

[c] *Official Records of the General Assembly, Thirty-first Session, Annexes*, agenda item 108, document A/31/390, para. 27.

vite the States which had not ratified or acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 to consider the possibility of adhering thereto, and that the General Assembly, by resolution 3108 (XXVIII), had acted accordingly. The Committee noted therefore with satisfaction that the Asian-African Legal Consultative Committee, at its seventeenth session in Kuala Lumpur, had recommended to States of the Asian-African region which had not ratified or acceded to the 1958 Convention to consider the possibility of ratification of or accession to the Convention.

C. *Recommendations of the Asian-African Legal Consultative Committee*

27. The Asian-African Legal Consultative Committee (AALCC), at its seventeenth session, also adopted a recommendation on international commercial arbitration by which it invited the Commission to consider the possibility of preparing a protocol to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 1958 (New York Convention of 1958), with a view to clarifying, *inter alia*, the following:

"(*a*) Where the parties have adopted rules for the conduct of an arbitration between them, whether the rules are for *ad hoc* arbitration or for institutional arbitration, the arbitration proceedings should be conducted pursuant to those rules notwithstanding provisions to the contrary in municipal laws and the award rendered should be recognized and enforced by all Contracting States;

"(*b*) Where an arbitral award has been rendered under procedures which operate unfairly against either party, the recognition and enforcement of the award should be refused;

"(*c*) Where a governmental agency is a party to a commercial transaction in which it has entered into an arbitration agreement it should not be able to invoke sovereign immunity in respect of an arbitration pursuant to that agreement."

28. The Committee had before it a note by the Secretary-General containing the text of the recommendations of the AALCC (A/CN.9/127)* and a note by the Secretariat setting forth the Secretariat comments on the proposals made by the AALCC in its recommendations (A/CN.9/127/Add.1).

29. After hearing a statement by the Secretary-General of the AALCC, the Committee considered separately the matters referred to in subparagraphs (*a*) and (*b*) and in subparagraph (*c*) of paragraph 27 above.

30. There was agreement in the Committee that the matters which the AALCC had brought to the attention of the Committee raised important issues in the context of international commercial arbitration and justified further consideration by the Commission. It was noted that these matters might be important not only to the Asian and African regions but also to other regions of the world. The view was also generally held that the Committee was not, at this stage, in a position to ascertain all aspects and implications of the AALCC's proposals and could therefore not pronounce itself on their feasibility and means of their implementation until after further study of these aspects and implications had been made.

31. The predominant opinion in the Committee was that, if it were decided at a later stage to implement the proposals of the AALCC, the preparation of a protocol to the 1958 New York Convention was not an appropriate approach. In this connexion, various suggestions were made. According to one suggestion, in considering the kind of legal means which might be used in establishing the relationship between, for example, the UNCITRAL Arbitration Rules and national laws on arbitral procedure, one method that might be studied could be a brief convention that would reverse the order of precedence established by article 1 (2) of those Rules. Such a convention might provide, in substance, that where the parties have agreed to arbitration under the UNCITRAL Arbitration Rules and where a provision of these Rules is in conflict with a provision of national law applicable to the arbitration from which the parties cannot derogate, the provision of the UNCITRAL Arbitration Rules shall prevail. It was noted that this might be a simpler approach than a convention in the form of a complete uniform law of arbitration. According to another view, the possibility might be studied of preparing a new international convention of a uniform law on arbitration which would draw upon the 1961 European Convention on International Commercial Arbitration. Attention was also drawn in this connexion to the 1966 European Convention providing a Uniform Law on Arbitration and the Inter-American Convention on Commercial Arbitration (Panama, 1975). Under yet another view, it was premature to consider means of implementation before the Commission had reached a conclusion on the substance of measures, if any, which might need implementation.

32. With respect to the proposal by the AALCC that the reliance on sovereign immunity should be excluded in international arbitration, the view was expressed that an optional model clause might be drafted which could be used in conjunction with the UNCITRAL Arbitration Rules. Under such an optional clause, States, state-owned agencies and entities of public law which entered into transactions with private firms would expressly agree not to invoke sovereign immunity in connexion with arbitration and possible enforcement of the award. However, it was stressed that further study was needed of the feasibility and legal effect of such an approach.

33. With regard to the issue of jurisdictional and sovereign immunity in connexion with arbitration, reservations were expressed, as a matter of principle, that in so far as States or Governments were concerned, this issue was but a part of a more general and complex problem having an obviously political and public international law character. At the same time, it was pointed out that in so far as the foreign trade organizations in socialist countries, referred to in the note of the Secretariat, were concerned these organizations, being autonomous legal persons, could not invoke and had never invoked such immunity.

34. The Committee had an exchange of views on the issues that should be further studied. The view was expressed that a study should be made of the relationship of arbitration rules to national laws and that, at least initially, attention should be focused on the UNCITRAL Arbitration Rules. Such a study, if so focused, might possibly eliminate the need to consider the problem of defining standards of fairness referred to in the AALCC's proposals. It was submitted, in this connexion, that if all arbitration rules were to be given precedence over contrary provisions of national law, there might then be a need to provide for exceptions so that such status would not be given to rules which operate unfairly. If, however, the focus was on the UNCITRAL Arbitration Rules, there would be no need to define standards of fairness. This was because these Rules, having been drawn up under the aegis of the United Nations, and having been recommended by the General Assembly, may be universally accepted as providing fair procedures of arbitration. It was noted that reference to the action of the General Assembly in recommending the UNCITRAL Arbitration Rules was not meant to imply unfairness in other existing arbitration procedures. It was also noted that in no event should the matter of fairness be dealt with in such a way as to expand the potential grounds for non-recognition of arbitral awards. On the other hand, it was pointed out that public policy, which was a ground for non-recognition of arbitral awards under the New York Convention of 1958, should not be restricted. The view was expressed that the study to be undertaken should include consideration of the feasibility of various means which might be used so that arbitration proceedings could be conducted pursuant to such Rules notwithstanding contrary provisions of national law.

35. Note was also taken of the discussion in paragraph 8 of the note of the Secretariat (A/CN.9/127/Add.1) concerning the relationship of arbitration rules to national laws under the provisions of article V of the 1958 New York Convention. The view was expressed that further exploration of this important and complex matter might usefully be included in the studies to be undertaken.

*Reproduced in part two of this volume.

36. The Committee was of the view that the Secretariat should be requested to study the various aspects and implications of the matters raised by the AALCC, and that it should do so in consultation with the AALCC. The Secretariat, in carrying out its studies, should take into account the observations and suggestions made in the course of the discussions in the Committee, and should also seek information, if necessary, from Governments, regional international organizations and arbitration institutions, in particular from the International Council for Commercial Arbitration (ICCA).

Decision of the Committee

37. The Committee, after deliberation, decided to recommend to the Commission that it adopt the following decision:

[*The text is not reproduced; for the decision as adopted by the Commission, see paragraph 39 of the Commission's report, above.*]

CHAPTER IV

LIABILITY FOR DAMAGE CAUSED BY PRODUCTS INTENDED FOR OR INVOLVED IN INTERNATIONAL TRADE

38. The General Assembly, at its twenty-eighth session, adopted resolution 3108 (XXVIII) of 12 December 1973 on the report of the United Nations Commission on International Trade Law on the work of its sixth session. In paragraph 7 of the resolution, the General Assembly invited the Commission

"To consider the advisability of preparing uniform rules on the civil liability of producers for damage caused by their products intended for or involved in international sale or distribution, taking into account the feasibility and most appropriate time therefor in view of other items on its programme of work."

39. At its seventh session the Commission had before it a note by the Secretary-General (A/CN.9/93) setting forth background information relating to this paragraph of the resolution and suggesting possible action by the Commission in response thereto. At that session, the Commission decided to request the Secretary-General to prepare a report containing a survey of the work of other organizations in respect of civil liability for damage caused by products, a study of the main problems that may arise in this area and the solutions that are being contemplated therefor by international organizations, and suggestions with respect to the Commission's future course of action.[d]

40. At its eighth session the Commission considered a report prepared in response to the decision taken at its seventh session entitled "Liability for damage caused by products intended for or involved in international trade" (A/CN.9/103),* and requested the Secretary-General to prepare a further report examining a number of specific issues set forth in the decision adopted at that session. These issues were the following:

"(*a*) The extent to which the absence of unified rules on products liability affects international trade;

"(*b*) The practicability and advantages of unification at a global level, as opposed to unification at a regional level;

"(*c*) The relationship between this subject and schemes of insurance which have been or may be developed in relation thereto;

"(*d*) The extent to which the manner in which liability may be limited, and the possible effects of different techniques of limitation;

"(*e*) The types of product in regard to which liability should be imposed;

"(*f*) The classes of persons on whom liability may be imposed and the classes of persons in whose favour liability may be imposed, with particular reference to the protection of consumers;

"(*g*) The kinds of damage for which compensation may be recoverable;

"(*h*) The kinds of transaction falling within the scope of the proposed uniform rules;

"(*i*) The relationship between any proposed uniform rules and standards of safety in relation to products which are mandatorily imposed in many States by national law."[e]

41. In addition, the Commission was of the view that the Secretariat should "consider the advisability of circulating, at an appropriate time, a questionnaire designed to elicit information on relevant legal rules and case law, and also on governmental attitudes to the issues involved".[f]

42. At the present session the Commission had before it two reports of the Secretary-General: (*a*) a report containing an analysis of the replies by Governments to a questionnaire prepared by the Secretariat (A/CN.9/139),* and (*b*) a report on "liability for damage caused by products involved in international trade" (A/CN.9/133).*

43. The first report (A/CN.9/139)* analyses 35 replies from Governments to the questionnaire on existing legislation, case law and law projects, in respect of contractual and extra-contractual liability. The other report (A/CN.9/133)* sets forth the special features of products liability law and evaluates general policy considerations, discusses various concepts of liability with a view to determining an appropriate basis of uniform products liability, sets out and evaluates the arguments pertaining to certain additional requirements and elements which relate to the scope and extent of liability, examines the insurance implications of such proposals concerning the basis or extent of liability, and contains suggestions as to a possible future course of action.

44. The Committee expressed its appreciation to the Secretariat for the thorough work it had carried out in respect of products liability.

45. The views expressed in the Committee led to the consensus that, in view of the different stages of development of the law on products liability, it was not now desirable to continue work on the subject and that, amongst the other matters on the Commission's agenda, it should not be retained with priority status. An attempt to unify the law in the field would burden the Commission's resources for a long time to come and this was not warranted under the circumstances. It was also pointed out that, in many countries, the subject of products liability had not yet fully been studied and that also the economic and insurance implications of a uniform scheme could, as yet, not be fully grasped.

Decision of the Committee

46. The Committee, after deliberation, decided to recommend to the Commission that it not pursue work on the subject of products liability at this time and that the matter be reviewed in the context of its future programme of work at a future session if one or more member States of the Commission should take an initiative to that effect.

CHAPTER V

TRAINING AND ASSISTANCE IN THE FIELD OF INTERNATIONAL TRADE LAW

47. The Committee had before it a note by the Secretary-General (A/CN.9/137)* setting forth the actions taken by the Secretariat to implement the Commission's decisions on train-

[d] *Official Records of the General Assembly, Twenty-ninth Session, Supplement No. 17* (A/9617), para. 81 (Yearbook . . . , 1974, part one, II, A).

*Yearbook . . . , 1975, part two, V.

[e] *Ibid., Thirtieth Session, Supplement No. 17* (A/10017), para. 103 (Yearbook . . . , 1975, part one II, A).

[f] *Ibid.*, para. 102.

* Reproduced in part two of this volume.

ing and assistance in the field of international trade law taken at its ninth session.[6]

A. *Second UNCITRAL Symposium*

48. The Committee noted with regret that the Second UNCITRAL Symposium on International Trade Law which was to have been held in connexion with the Commission's tenth session had to be cancelled for lack of funds. Many representatives, while commending the Secretariat's efforts in soliciting voluntary contributions towards the Symposium, expressed their disappointment at the response which such efforts had drawn.

49. The Committee expressed its appreciation to those Governments which had made or pledged voluntary contributions towards the Symposium and, noting the high number of candidates who had sought to participate in the Symposium, expressed its regrets to those candidates for the disappointment which cancellation of the Symposium may have caused them.

50. On the question whether the Commission should plan on holding future symposia on international trade law, there was general agreement within the Committee that the symposia were a most useful and desirable feature of the Commission's work and of its training and assistance programme in particular which should, therefore, be maintained. Not only, it was observed, did the symposia benefit young lawyers from both developing and developed countries, they also provided a forum for eminent specialists and other experts from different legal and economic systems to exchange views on the work of UNCITRAL, all of which served the additional purpose of publicizing the Commission's work.

51. The view was expressed that the symposia should not be too theoretical in their conception and execution if they were to be useful training for young lawyers. Priority should perhaps therefore be given to securing more fellowships and internship opportunities for such lawyers to undergo training at commercial and financial institutions within the developed countries. It was, however, pointed out in response by several delegates that the two elements of the Commission's training and assistance programme served different functions and neither could truly replace the other: a symposium sought within a relatively short period of intensive discussion to promote understanding of and foster expertise in a specific topic or number of topics, whereas the fellowship and internship opportunities were more of a general post-graduate training in international trade law. It was further observed that fellowships by their very nature can benefit only a very limited number of individuals in contrast to the very large number of persons who can be reached through the symposia, and that there was, at any rate, nothing in the idea of a symposium to preclude concentration on a topic of practical value, as was revealed by the topics which the Commission had selected for the Second UNCITRAL Symposium: "Transport and financing documents used in international trade" and the "UNCITRAL Arbitration Rules".

52. On the question of financing the symposia, the Committee was agreed on the need to find alternative means to the present system of total reliance on voluntary contributions from Governments and other sources, which system, as was attested to by the cancellation of the planned Second UNCITRAL Symposium for insufficiency of funds, had proven unreliable. Recalling the suggestion made in the Sixth Committee during that Committee's consideration of the report of the Commission on the work of its ninth session, namely, that consideration be given to financing this activity out of the regular budget of the United Nations, the Committee decided to make a recommendation to that effect to the Commission.

53. A number of representatives stated, however, that they were not in a position to commit their respective Governments to any particular line of action with respect to such budgetary matters. The view was also expressed that it would be preferable before a recommendation was addressed to the General Assembly, to request the Secretariat to explore, with the appropriate United Nations bodies, possibilities of obtaining such financing and to inform the Commission accordingly at its next session.

Decision of the Committee

54. The Committee decided to recommend to the Commission for adoption the following decision:

[*The text is not reproduced; for the decision as adopted by the Commission, see paragraph of the Commission's report, above.*]

B. *Fellowships and internship arrangements for training in international trade law*

55. The Committee noted with appreciation the decision of the Government of Belgium to reinstate for 1977 and, as had been announced by the representative of Belgium at the session, to award also for 1978, the two fellowships for academic and practical training in international trade law which that Government had generously made available in the past to suitable candidates from developing countries.

56. The Committee also expressed its appreciation to The Hague Conference on Private International Law for its offer of a fellowship to enable a candidate from a developing country to undertake an internship at the Permanent Bureau of the Conference for a period of one year.

CHAPTER VI

OTHER BUSINESS

Consistency of legal provisions drafted by the Commission or its Working Groups

57. The Committee had before it a note by the Secretariat on this item (A/CN.9/138).

58. Following a brief statement by the Chairman in which he observed that the problem of how to achieve and maintain consistency of legal provisions was a perennial one in the elaboration of international conventions and that perhaps no satisfactory solution to the problem existed, or was easily discoverable, the Committee took note of the issues raised in the Secretariat's note.

ANNEX III

List of documents before the Commission

[Annex not reproduced; see check list of UNCITRAL documents at the end of this volume.]

[6] *Ibid., Thirty-first Session, Supplement No. 17* (A/31/17), paras. 59-64 (UNCITRAL Yearbook, vol. VI: 1975, part one, II, A).

B. List of relevant documents not reproduced in the present volume

Document reference	*Title or description*
A/CN.9/127/Add. 1	International Commercial Arbitration: comments by the Secretariat on the decision by the Asian-African Legal Consultative Committee on International Commercial Arbitration taken at its seventeenth session; note by the Secretariat
A/CN.9/130	Security interests; report of the Secretary-General
A/CN.9/134	Provisional agenda, annotations thereto, and tentative schedule of meetings; note by the Secretary-General
A/CN.9/136	General conditions of sale and standard contracts; report of the Secretary-General
A/CN.9/138	Consistency of legal provisions drafted by the Commission on its Working Groups; note by the Secretariat
A.CN.9/140	Possible conference of plenipotentiaries to conclude a convention on the international sale of goods: financial implications; note by the Secretary-General

I. INTERNATIONAL SALE OF GOODS

A. Report of the Working Group on the International Sale of Goods on the work of its eighth session (New York, 4–14 January 1977) (A/CN.9/128)*

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INTRODUCTION

1. The Working Group on the International Sale of Goods was established by the United Nations Commission on International Trade Law at its second session held in 1969. The Commission at its 44th meeting, on 26 March 1969, requested the Working Group to ascertain which modifications of the Hague Convention of 1964 relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods might render it capable of wider acceptance by countries of different legal, social and economic systems and to elaborate a new text reflecting such modifications.[1] At its third session the Commission decided that the Working Group should commence its work on formation of contracts when it had completed its work on the revision of the Uniform Law on the International Sale of Goods.[2]

2. The Working Group is currently composed of the following States members of the Commission: Austria, Brazil, Czechoslovakia, France, Ghana, Hungary, India, Japan, Kenya, Mexico, Philippines, Sierra Leone, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland and United States of America.

3. The Working Group held its eighth session at the Headquarters of the United Nations in New York from 4 to 14 January 1977. All members of the Working Group were represented.

4. The session was also attended by observers from the following members of the Commission: Argentina, Australia, Bulgaria, Chile, Cyprus, Gabon, Germany, Federal Republic of, and Poland. Observers from Canada, Finland, and the German Democratic Republic also attended the session.[3] In addition, the session was attended by observers from the following international organizations: East African Community, Hague Conference on Private International Law, the International Institute for the Unification of Private Law (UNIDROIT) and the Inter-American Juridical Committee.

5. The Working Group elected the following officers:
Chairman ..... Mr. Jorge Barrera-Graf (Mexico)
Rapporteur ..... Mr. Gyula Eörsi (Hungary)

6. The following documents were placed before the Working Group:

(*a*) Provisional agenda and annotations (A/CN.9/WG.2/L.3);

(*b*) Report of the Secretary-General: formation and validity of contracts for the international sale of goods (A/CN.9/WG.2/WP.26 and Add.1).[4] The Secretariat prepared for the consideration of the Working Group a draft of a convention on the formation of contracts for the international sale of goods (A/CN.9/WG.2/WP.26, annex I).[5] The Secretariat also prepared a critical analysis of the UNIDROIT draft law on the validity of contracts of international sale of goods (A/CN.9/WG.2/WP.26/Add.1);[6]

(*c*) Convention relating to a uniform law on the formation of contracts for the international sale of goods, with annexes (extract from the *Register of Texts and Conventions and other Instruments concerning International Trade Law, Vol. I* (United Nations publication, Sales No. E. 71.V.3));

(*d*) Analysis of replies and comments by Governments on the Hague Convention of 1964 on the Formation of Contracts for the International Sale of Goods (A/CN.9/31, paras. 144 to 156; UNCITRAL Yearbook, vol. I: 1968-1970, part three, I);

(*e*) Draft of a law for the unification of certain rules relating to validity of contracts of international sale of goods, followed by an explanatory report (UNIDROIT, ETUDE XVI/B, Document 22, U.D.P. 1972, French and English only).

7. The Working Group adopted the following agenda:

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* 3 February 1977.

[1] Report of the Commission on the work of its second session (1969), A/7618 (Yearbook ..., 1968–1970, part two, II, A).

[2] Report of the Commission on the work of its third session (1970), A/8017 (Yearbook ..., 1968–1970, part two, III, A).

[3] Finland and the German Democratic Republic were elected to the Commission by the General Assembly at its thirty-first session. Their terms commence on the first day of the Commission's tenth session.

[4] Reproduced as annex II to the present report. Annex I contains the text of the draft convention on the formation of contracts for the international sale of goods, as approved or deferred for further consideration by the Working Group on the International Sale of Goods at its eighth session. References to those annexes hereinafter replace references to documents A/CN.9/WG.2/WP.26 and Add.1.

[5] Annex II to the present report, appendix I.

[6] *Ibid.*, appendix II.

(1) Opening of the session
(2) Election of officers
(3) Adoption of the agenda
(4) Formation and validity of contracts for the international sale of goods
(5) Other business
(6) Date of the next session
(7) Adoption of the report of the session.

8. In the discussion of the adoption of agenda item 4, the Working Group noted the view of the Commission at its ninth session that "the Working Group should restrict its work to the preparation of rules on the formation of contracts for the international sale of goods so as to complete its task in the shortest possible time, but that the Working Group had discretion as to whether to include some rules in respect of the validity of such contracts".[7]

9. Accordingly, the Working Group decided to consider firstly the 1964 Hague Uniform Law on the Formation of Contracts for the International Sale of Goods[8] together with the proposed alternative provisions contained in the report of the Secretary-General (annex II, appendix I). However, during its consideration of this item any representative or observer could refer to such questions of validity which appeared to be related to the draft provisions on formation.

10. Secondly, the Working Group would consider the general question of validity of contracts and, in particular, the UNIDROIT draft of a law for the unification of certain rules relating to validity of contracts of international sale of goods and the critical analysis of these provisions prepared by the Secretariat (annex II, appendix II).

I. Formation of contracts for the international sale of goods

Article 1

11. The text of article 1 in Annex I of the 1964 Convention for use by those States which have not adopted the Uniform Law of the International Sale of Goods is as follows:

"1. The present Law shall apply to the formation of contracts of sale of goods entered into by parties whose places of business are in the territories of different States, in each of the following cases:

"(*a*) Where the offer or the reply relates to goods which are in the course of carriage or will be carried from the territory of one State to the territory of another;

"(*b*) Where the acts constituting the offer and the acceptance are effected in the territories of different States;

"(*c*) Where delivery of the goods is to be made in the territory of a State other than that within whose territory the acts constituting the offer and the acceptance are effected.

"2. Where a party does not have a place of business, reference shall be made to his habitual residence.

"3. The application of the present Law shall not depend on the nationality of the parties.

"4. Offer and acceptance shall be considered to be effected in the territory of the same State only if the letters, telegrams or other documentary communications which contain them are sent and received in the territory of that State.

"5. For the purpose of determining whether the parties have their places of business or habitual residences in 'different States', any two or more States shall not be considered to be 'different States' if a valid declaration to that effect made under Article II of the Convention dated the 1st day of July 1964 relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods is in force in respect of them.

"6. The present Law shall not apply to the formation of contracts of sale:

"(*a*) Of stocks, shares, investment securities, negotiable instruments or money;

"(*b*) Of any ship, vessel or aircraft, which is or will be subject to registration;

"(*c*) Of electricity;

"(*d*) By authority of law or on execution or distress.

"7. Contracts for the supply of goods to be manufactured or produced shall be considered to be sales within the meaning of the present Law, unless the party who orders the goods undertakes to supply an essential and substantial part of the materials necessary for such manufacture or production.

"8. The present Law shall apply regardless of the commercial or civil character of the parties or of the contracts to be concluded.

"9. Rules of private international law shall be excluded for the purpose of the application of the present Law, subject to any provision to the contrary in the said Law."

12. The text of article I in Annex II of the 1964 Convention for use by those States which have adopted the Uniform Law on the International Sale of Goods is as follows:

"The present Law shall apply to the formation of contracts of sale of goods which, if they were concluded, would be governed by the Uniform Law on the International Sale of Goods."

Discussion and decision

13. The Working Group was of the view that it was desirable to prepare an article on the scope of application of the draft Convention based upon the provisions in the draft Convention on the International Sale of Goods (CISG) even though the provisions on formation and validity may eventually be incorporated into that draft Convention.

14. The Working Group accordingly requested the Secretariat to prepare draft provisions on the scope of application of the Convention using the approach em-

[7] Report of the Commission on its ninth session (1976), A/31/17, para. 27 (Yearbook . . ., 1976, part one, II, A).

[8] The Uniform Law is hereafter referred to as ULF. The English and French language versions of ULF are the official texts as adopted by the 1964 Hague Conference. The Russian and Spanish language versions are unofficial translations reproduced from *Register of Texts of Conventions and other Instruments concerning International Trade Law*, vol. I (United Nations publication, Sales No. 71.V.3), chap. I, sect. 1.

ployed in the ULF and the appropriate provisions of the CISG. The Secretariat prepared two draft provisions. Alternative No. 1 was for use by those States which adopt the CISG. Alternative No. 2 was for use by those States which do not adopt the CISG. The text of these provisions is as follows:

[*Alternative No. 1*]

"This Convention applies to the formation of contracts of sale of goods which, if they were concluded, would be governed by the Convention on the International Sale of Goods."

[*Alternative No. 2*]

"(1) This Convention applies to the formation of contracts of sale of goods entered into by parties whose places of business are in different States:

"(*a*) When the States are Contracting States; or

"(*b*) When the rules of private international law lead to the application of the law of a Contracting State.

"(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the offer, any reply to the offer, or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.

"(3) This Convention does not apply to the formation of contracts of sale:

"(*a*) Of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, did not know and had no reason to know that the goods were bought for any such use;

"(*b*) By auction;

"(*c*) On execution or otherwise by authority of law;

"(*d*) Of stocks, shares, investment securities, negotiable instruments or money;

"(*e*) Of ships, vessels or aircraft;

"(*f*) Of electricity.

"(4) This Convention does not apply to the formation of contracts in which the predominant part of the obligations of the seller consists in the supply of labour or other services.

"(5) The formation of contracts for the supply of goods to be manufactured or produced is to be considered as the formation of contracts of sale of goods unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production.

"(6) For the purposes of this Convention:

"(*a*) If a party has more than one place of business, the place of business is that which has the closest relationship to the proposed contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract;

"(*b*) If a party does not have a place of business, reference is to be made to his habitual residence;

"(*c*) Neither the nationality of the parties nor the civil or commercial character of the parties or of the proposed contract is to be taken into consideration."

15. The Working Group decided that these draft provisions should be placed in square brackets to indicate that they would have to be reconsidered in the light of any changes which the Commission might make to the scope of application of the draft CISG.

16. A suggestion was made that article 1, paragraphs (2) and (6) (*a*) of alternative No. 2, be limited to events prior to the conclusion of the contract. This suggestion was objected to on the grounds that such a limitation was not contained in the draft CISG and that there was no reason to have one rule in respect of the scope of application of the CISG and another in respect of the scope of application of the present Convention.

17. It was noted that the draft of alternative No. 1 could lead to the situation that if the parties to a transaction were from States both of which had adopted CISG but only one of which had adopted the present Convention, the courts of the State which had adopted the present Convention would be required to apply it to the transaction whereas the courts of the other States would not.

Article 2

18. The text of article 2 of ULF is as follows:

"1. The provisions of the following articles shall apply except to the extent that it appears from the preliminary negotiations, the offer, the reply, the practices which the parties have established between themselves or usage, that other rules apply.

"2. However, a term of the offer stipulating that silence shall amount to acceptance is invalid."

19. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"The provisions of the following articles apply except to the extent that the preliminary negotiations, the offer, the reply, any practices that the parties have established between themselves or usage lead to the application of more stringent legal rules or more stringent agreed principles to determine whether a contract has been concluded."

Discussion and decision

20. The Working Group decided that article 2 should clearly state that the parties could exclude the uniform law as a whole, so that the applicable national law would govern. As to the extent to which particular rules could be excluded or modified by the parties, it was decided that the general principle should be that of autonomy of the will of the parties. However, it was recognized that in the subsequent discussion of the substantive provisions the Working Group might decide that the parties could not derogate from or vary certain of those provisions, especially if it was later decided to incorporate provisions on validity into the text.

21. It was decided that article 2 (2) of UFL should be retained, although there was some sentiment for including it in article 6.

22. Several representatives and an observer stated that the concept that an article could only be modified or excluded by more stringent legal rules or more stringent agreed principles, as suggested in the alternative text proposed by the Secretariat, could cause consider-

able difficulty since it was not always easy to determine whether a legal rule or agreed principle was "more stringent" than the rules contained in ULF or the alternative text proposed by the Secretariat.

23. A Drafting Party consisting of the representatives of Brazil, Czechoslovakia and the United States and the observer for UNIDROIT, was set up to draft a new text.

24. The text proposed by the Drafting Group was as follows:

"(1) The parties may exclude the application of this Convention.

"(2) Unless the Convention provides otherwise, the parties may derogate from or vary the effect of any of its provisions as may appear from the preliminary negotiations, the offer, the reply, the practices which the parties have established between themselves or usages widely known and regularly observed in international trade."

25. It was decided to add the words "agree to" before the word "exclude" in paragraph (1) and before "derogate" in paragraph (2). These words were placed in square brackets because some representatives believed that it was difficult to speak of the agreement of the parties prior to the conclusion of the contract.

26. The view was expressed that the most likely manner in which the parties would act to exclude the application of this Convention was by the choice of a specific national law to govern the contract. It was also suggested that the parties should not be able to exclude the application of this Convention unless they stated the law which would be applicable. One representative was opposed to paragraph (1) because, in his view, the parties should not be permitted to exclude the application of the Convention.

27. In respect of article 2 (2) of the proposal, the Working Group deleted the words following the word "usages" since "usages" were defined in article 13.

28. Several representatives suggested that the expression "the practices the parties have established between themselves or usages" should be deleted as it was unlikely that such practices or usages exist.

29. The decision to retain article 2 (2) of ULF was reaffirmed and it was placed as paragraph (3) of this article pending a general reordering of the text.

Article 3

30. The text of article 3 of ULF is as follows:

"An offer or an acceptance need not be evidenced by writing and shall not be subject to any other requirement as to form. In particular, they may be proved by means of witnesses."

31. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"Neither the formation or validity of a contract nor the right of a party to prove its formation or any of its provisions depends upon the existence of a writing or any other requirement as to form. The formation of the contract, or any of its provisions, may be proved by means of witnesses or other appropriate means."

Discussion and decision

32. There was support for the view that consideration of matters concerning form of contracts should be postponed until the Commission finalized article 11 of the draft CISG which had been left in square brackets because the Working Group had been unable to reach agreement on such questions of form.

33. It was noted that the use of the expression "need not be evidenced by writing" in the English language version of article 3 of ULF suggested that the article regulated only matters of evidence and of the proper form of the offer and the acceptance but that it did not overcome a national rule of law that a contract for the international sale of goods must be in writing either to be validly formed or to be enforceable before the courts of that country. It was further noted, however, that the French language versions of article 3 of ULF and article 11 of the draft CISG used the phrase "aucune forme n'est prescrite pour . . . " which suggested that the article went to questions of validity and enforceability. It was suggested that the fact that the different language versions of the text were not identical be brought to the attention of the Commission at its tenth session for its consideration during the discussion of article 11 of the draft CISG.

34. It was also noted that it might be possible to reach a compromise in relation to the problem of form of contracts by retaining the substance of article 3 of ULF with a proviso that it did not overcome contrary provisions in the municipal laws of the place of business of either party.

35. In view of the fact that the Commission would consider article 11 of the draft CISG at its tenth session in May, the Working Group decided to place both versions of article 3 in square brackets and to record in the report the compromise solution suggested above, which relates to all articles that deal with the question of the form of any declarations or expressions of intention of the parties.

Article 3A

36. The text of article 3A as proposed by the Secretariat (annex II, appendix I) is as follows:

"(1) An agreement by the parties made in good faith to modify or rescind the contract is effective. However, a written contract which excludes any modification or rescission unless in writing cannot be otherwise modified or rescinded.

"(2) Action by one party on which the other party reasonably relies to his detriment may constitute a waiver of a provision in a contract which requires any modification or rescission to be in writing. A party who has waived a provision relating to an unperformed portion of the contract may retract the waiver. However, a waiver cannot be retracted if the retraction would result in unreasonable inconvenience or unreasonable expense to the other party because of his reliance on the waiver."

The provision in general

37. The view was expressed that article 3A, since it did not strictly relate to the formation of contracts, did not belong in the draft Convention on formation. It was also suggested that it would be appropriate for the Working Group to transmit the proposal to the Commission for its possible inclusion in the draft Convention on the In-

ternational Sale of Goods. The Working Group, after deliberation, was of the view that the issues raised by its provisions were of such importance that the article should be retained in the draft Convention on formation.

First sentence of article 3A paragraph (1)

38. It was noted that this provision performed a useful function, particularly in common law jurisdictions which retained the doctrine of consideration. The introduction of this provision would enable the parties to modify or rescind a contract even though consideration was lacking, e.g., where the obligations of only one of the parties was affected.

39. The view was expressed, however, that the requirement that the modification be "in good faith" would not be interpreted the same in all countries. There was some support for the view that the words "in good faith" could be replaced by other expressions such as "freely" or "in conformity with fair dealing". There was also support for the view that the first sentence be recast in terms making inapplicable any rule of municipal law requiring consideration for modification or rescission of contracts. This would make it clear that questions of "good faith" were not involved. Another suggestion was to delete the provision and replace it with an article which made the provisions on formation applicable to modification and rescission of contracts. Yet another view was to delete the words "in good faith" and deal with the problem of improper pressures in a separate provision on questions of validity.

Second sentence of article 3A, paragraph (1) and article 3A, paragraph (2)

40. There was considerable support for the retention of the second sentence of article 3A, paragraph (1). However, the reasons for this support varied.

41. On the one hand, some support was dependent upon also retaining article 3A (2). The combined effect of these provisions would enable a written contract which excluded any modification or rescission unless in writing to be modified or rescinded without a writing if the conditions in article 3A (2) were met.

42. On the other hand, there was some support for the retention of the second sentence of article 3A (1) because it gave supremacy to the written terms of a contract. A representative sharing this opinion proposed the deletion of article 3A (2). He reserved his position should that article be retained since it raised the same type of problems as were posed by article 3.

43. In relation to article 3A (2), it was suggested that the general approach should be consistent with that taken in relation to article 3 and accordingly article 3A (2) if retained, should be placed in square brackets. In addition, a number of representatives considered article 3A (2) complex and unclear and suggested that, if it were retained, it should be simplified.

Action by the Working Group

44. The Working Group established a drafting party, consisting of the representatives of Austria, Czechoslovakia, the United Kingdom of Great Britain and Northern Ireland and the observer for UNIDROIT to draft provisions based on these considerations.

45. The Drafting Party proposed the following text:

"(1) The contract may be modified or rescinded merely by agreement of the parties [made in conformity with fair dealing].

"(2) A written contract which contains a provision requiring any modification or rescission to be in writing may not be otherwise modified or rescinded. However, a party may be precluded by his action from asserting such a provision to the extent that the other party has relied to his detriment on that action."

Discussion and decision

46. Although some representatives favoured the retention of the words in square brackets in paragraph (1) until the Working Group decided whether the draft Convention would contain a separate provision on good faith and fair dealing, the Working Group decided to delete them.

47. The Working Group placed the second sentence of paragraph (2) in square brackets to indicate that, while a number of representatives opposed the provision, other representatives considered that it should be reconsidered at a later stage since it dealt with a practical problem in international trade.

Article 4

48. The text of article 4 of ULF in annex I of the 1964 Convention for use by the States which have not adopted the Uniform Law on the International Sale of Goods is as follows:

"1. The communication which one person addresses to one or more specific persons with the object of concluding a contract of sale shall not constitute an offer unless it is sufficiently definite to permit the conclusion of the contract by acceptance and indicates the intention of the offeror to be bound.

"2. This communication may be interpreted by reference to and supplemented by the preliminary negotiations, any practices which the parties have established between themselves, usage and any applicable legal rules for contracts of sale."

49. The text of article 4 of ULF in annex II of the 1964 Convention for use by those States which have adopted the Uniform Law on the International Sale of Goods is as follows:

"1. The communication which one person addresses to one or more specific persons with the object of concluding a contract of sale shall not constitute an offer unless it is sufficiently definite to permit the conclusion of the contract by acceptance and indicates the intention of the offeror to be bound.

"2. This communication may be interpreted by reference to and supplemented by the preliminary negotiations, any practices which the parties have established between themselves, usage and the provisions of the Uniform Law on the International Sale of Goods."

50. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"(1) A communication directed to one or more specific persons [or to the public] with the object of concluding a contract of sale constitutes an offer if it is sufficiently definite and indicates the intention of the offeror to be bound.

"(2) This communication may be interpreted by

reference to and supplemented by the preliminary negotiations, any practices which the parties have established between themselves, usage and any applicable legal rules for contracts of sale.

"(3) An offer is sufficiently definite if it expressly or impliedly indicates at least the kind and quantity of the goods and that a price is to be paid.

"(4) Subject to the contrary intention of the parties, an offer is sufficiently definite even though it does not state the price or expressly or impliedly make provision for the determination of the price of the goods. In such cases, the buyer must pay the price generally charged by the seller at the time of the conclusion of the contract. If no such price is ascertainable, the buyer must pay the price generally prevailing at the aforesaid time for such goods sold under comparable circumstances.

"(5) An offer is sufficiently definite if it measures the quantity by the amount of goods available to the seller or by the requirements of the buyer. In such cases, the amount of goods available to the seller or the requirements of the buyer means the actual amount available or the actual amount required in good faith. However, the buyer is not entitled to demand nor compelled to accept a quantity unreasonably disproportionate to any stated estimate, or in the absence of a stated estimate, a quantity unreasonably disproportionate to any normal or otherwise comparable amount previously available or required."

Discussion

51. The Working Group decided to conduct its discussions on the basis of the alternative text.

Article 4 paragraph (1)

52. The discussion focused on two questions: (1) whether it was common for "offers to the public" for international sales of goods to be sufficiently definite and to indicate the requisite intention on the part of the offeror to conclude a contract of sale so as to qualify as offers in the legal sense and (2) whether "offers to the public" which met the test of definiteness and intent should be considered to be offers in the legal sense or whether an offer in a legal sense must be made to one or more specific persons.

53. The general view of the Working Group was that few "offers to the public" met the test of definiteness or indicated an intent to conclude a contract of sale. However, the Working Group was informed that a recent UNIDROIT survey found that public offers were becoming more important in international trade.

54. One view expressed in the Working Group was that the reference to public offers should be retained in article 4 (1). Another view was that the references to public offers should be deleted. Some representatives expressed the opinion that offers to "one or more specific persons" could approach the situation generally described as a public offer if the offer was made to a large number of specific persons. The suggestion was also made to delete any reference to the number of possible addressees of the offer.

Article 4 paragraph (2)

55. After discussion the Working Group decided to delete article 4 (2) and to combine it with other provisions on interpretation in the ULF as well as with articles 3, 4 and 5 of the draft uniform law on validity of contracts in a new general provision on interpretation.

Article 4 paragraphs (3) and (4)

56. The Working Group considered these two paragraphs together.

57. Under one view a communication was too indefinite to be an offer if it did not itself fix the price or provide for the means of determining the price. Under this view article 36 of the draft CISG, from which the second and third sentences of article 4 (4) were taken, was for use by those countries under whose law a contract could be concluded without fixing the price or providing a means of determining the price. It could not be used as a justification for the introduction of such a test into a text of uniform law on the formation of contracts.

58. Under another view article 4 (3) and (4) gave a means by which the price could always be determined. Therefore, a communication which would otherwise be an offer should not be held to be too indefinite to be an offer because it failed to fix the price or give the means by which the price could be determined.

59. One representative proposed a compromise solution which, after several amendments, was expressed as follows:

"(3) An offer is sufficiently definite if it expressly or impliedly indicates at least the kind and quantity of the goods and states the price or expressly or impliedly makes provision for the determination of the price or indicates the intention to conclude the contract even without fixing the price or making provision for determination of the price in the contract.

"(4) If the proposal indicates the intention to conclude the contract even without fixing the price or making provision for the determination of the price in the contract, it is a proposal for sale of goods at the price generally charged by the seller at the time of the conclusion of the contract or if no such price is ascertainable, the price generally prevailing at the aforesaid time for such goods under comparable circumstances."

60. The Working Group accepted the principle of this proposal and referred it to the Drafting Group for it to consider a number of drafting points made during the discussion.

61. However, three representatives expressed reservations to this decision on the grounds that it transformed certain invitations to deal into offers by implying a price which the "offeror" had not himself indicated. One of these representatives also expressed a reservation as to the decision that the implied price was the price generally prevailing at the time of the conclusion of the contract.

Article 4 paragraph (5)

62. Most representatives favoured deletion of this provision. It was pointed out that the second and third sentences of article 4 (5) dealt with matters of performance rather than with the formation of contracts. Some representatives were of the view that the provision left the determination of the quantity of goods too indefinite for the communication to be an offer. One representative noted that it only considered certain matters that were not specific in the offer and omitted to deal with a number of other matters, such as delivery dates and

quality of the goods, which might also be decided upon after the making of the offer.

63. Under another view the provision offered a practical solution for a common form of contract. It was suggested that, if article 4 (5) was deleted, some provision should be made in article 4 (3) to indicate the possibility for the parties to provide for the means of determining the quantity of goods to be delivered.

64. The Work Group decided to delete article 4 (5) but requested the Drafting Group to take into account the suggestion made above.

Decision of the Working Group as to article 4

65. It was decided that the parties were not to be permitted to derogate from or vary the provisions of this article.

66. The Working Group created a Drafting Group consisting of the representatives of Austria, France, the United Kingdom and the USSR and requested it to present a redraft of the entire article in the light of the decisions of the Working Group and the discussions which had been held.

67. The Drafting Group proposed the following text:

"(1) A proposal for concluding a contract constitutes an offer if it is sufficiently definite and indicates the intention of the offeror to be bound in case of acceptance.

"(2) An offer is sufficiently definite if expressly or impliedly it indicates the kind of the goods and fixes or makes provision for determining the quantity and the price. Nevertheless, if the offer indicates the intention to conclude the contract even without making provision for the determination of the price, it is considered as a proposal that the price be that generally charged by the seller at the time of the conclusion of the contract or, if no such price is ascertainable, the price generally prevailing at the aforesaid time for such goods sold under comparable circumstances."

Discussion and decision

68. The Working Group decided to add the words "addressed to one or more specific persons" after the word "contract" in paragraph (1) in order to exclude specifically public offers from the ambit of the Convention. However, since there was opposition to a specific exclusion of public offers, these words were placed in square brackets for reconsideration at the next session of the Working Group.

69. The Working Group also decided to place the second sentence of paragraph (2) in square brackets to indicate the opposition of some representatives to the inclusion of a provision which would enable a proposal to be considered as an offer even though it does not indicate a price nor make provision for its determination.

Article 5

70. The text of article 5 of ULF is as follows:

"1. The offer shall not bind the offeror until it has been communicated to the offeree; it shall lapse if its withdrawal is communicated to the offeree before or at the same time as the offer.

"2. After an offer has been communicated to the offeree it can be revoked unless the revocation is not made in good faith or in conformity with fair dealing or unless the offer states a fixed time for acceptance or otherwise indicates that it is firm or irrevocable.

"3. An indication that the offer is firm or irrevocable may be express or implied from the circumstances, the preliminary negotiations, any practices which the parties have established between themselves or usage.

"4. A revocation of an offer shall only have effect if it has been communicated to the offeree before he has despatched his acceptance or has done any act treated as acceptance under paragraph 2 of article 6."

71. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"(1) The offer can be accepted only after it has been communicated to the offeree. It cannot be accepted if its withdrawal is communicated to the offeree before or at the same time as the offer.

"(2) After an offer has been communicated to the offeree it can be revoked if the revocation is communicated to the offeree before he has despatched his acceptance or has done any act treated as acceptance under article 6 (2). However, an offer cannot be revoked:

"(*a*) During any time fixed in the offer for acceptance; or

"(*b*) For a reasonable time if the offer otherwise indicates that it is firm or irrevocable; or

"(*c*) For a reasonable time if it was reasonable for the offeree to rely upon the offer being held open and the offeree has altered his position to his detriment in reliance on the offer.

"(3) An indication that the offer is firm or irrevocable may be express or may be implied from the circumstances, the preliminary negotiations, any practices which the parties have established between themselves or usage."

The provisions in general

72. The Working Group agreed to use the alternative text as the basis for discussion although there was support for the view that, in relation to paragraph (1), the approach of ULF was preferable.

Article 5 paragraph (1)

73. Those representatives who expressed the view that the approach taken in the drafting of article 5 (1) of ULF was preferable to that of the alternative text poined out that the ULF text clearly dealt with the effect of an offer, the subject-matter of article 5, whereas the alternative text appeared to deal with the time at which an acceptance could take place.

74. On the other hand it was pointed out that the alternative draft described the practical effect of an offer after its communication to the offeree. It also avoided the ambiguity which arose in article 5 (1) of ULF from the provision that "the offer shall not bind the offeror until it has been communicated". The use of the word "bind" suggested that the offer was irrevocable, which would conflict with the general principle of revocability of offers contained in article 5 (2) of ULF.

75. The Working Group decided to redraft article 5 (1) to conform to ULF but in a way that avoided such ambiguities.

76. In order to make it clear that the offeror could withdraw his offer if the withdrawal was communicated to the offeree before or at the same time as the offer even if the offer was irrevocable, the Working Group decided to add to the end of the second sentence of article 5 (1) the words "even if it is irrevocable". However, because some representatives did not believe the words were necessary, they were placed in square brackets. Another representative pointed out that the words in square brackets were necessary to avoid confusion with article 5 (2).

Article 5 paragraph (2)

77. After discussion it was decided that the basic compromise of the ULF should be retained; offers were in general revocable but they became irrevocable in a number of specific situations. It was thought that any fundamental change in this compromise might render a replacement text less acceptable.

78. The view was expressed that article 5 (2) (*a*) should be redrafted to distinguish between those offers which were intended to be irrevocable for a period of time and those offers which merely indicated the period of time before they lapsed. On the other hand the view was expressed that one of the main exceptions to the principle of revocability was precisely those occasions in which the offer fixed a time for acceptance. The Working Group decided to leave open this question until its next session by placing the word "acceptance" in square brackets immediately followed by the word "irrevocability" in square brackets.

79. There was general support for deleting from the beginning of subparagraphs (*a*), (*b*) and (*c*) any reference to the period of time during which an offer was irrevocable on the grounds that the offer normally remained irrevocable until it lapsed. It was agreed that there should not be two provisions on the period of time during which the offer could be accepted, one in article 5 (2) and the other in article 8.

80. The Working Group accepted subparagraph (*c*) on the understanding that this was a useful example of the general requirement that parties act in good faith. A number of representatives stated that they agreed to the retention of this subparagraph on the understanding that the draft Convention would contain a general provision dealing with the requirement to act in good faith.

81. In the discussion in respect of article 6 (2), the Working Group decided that the words "shipped the goods or paid the price" should be added to the first sentence of article 5 (2) following the words "before he has despatched his acceptance" but that they should be placed in square brackets for reconsideration at its next session. If these words were retained an offer otherwise revocable would become irrevocable once the offeree had shipped the goods or paid the price. In conjunction with this decision the second sentence of article 5 (2) became article 5 (3). A more complete discussion of this action is found in paragraphs 91 to 98 and 116 to 119.

82. One representative reserved his position in relation to article 5 (2) (*b*). Another representative stated that article 5 (2) (*b*) was acceptable provided the report noted that the provision would have the effect in some legal systems of transforming an offer which merely stated that it would expire after a certain period into an irrevocable offer.

83. A representative reserved his position in respect of article 5 (2) (*c*) on the basis that such a provision was vague and contained no safeguards to protect an innocent offeror.

Article 5 paragraph (3)

84. The Working Group deleted paragraph (3) of the alternative text on the ground that the question of interpretation should be dealt with in a separate provision.

Decision of the Working Group

85. The text of article 5 as adopted by the Working Group is as follows:

"(1) The offer becomes effective when it has been communicated to the offeree. It can be withdrawn if the withdrawal is communicated to the offeree before or at the same time as the offer [even if it is irrevocable].

"(2) The offer can be revoked if the revocation is communicated to the offeree before he has despatched his acceptance [, shipped the goods or paid the price].

"(3) However, an offer cannot be revoked:

"(*a*) If the offer expressly or impliedly indicates that it is firm or irrevocable; or

"(*b*) If the offer states a fixed period of time for [acceptance] [irrevocability]; or

"(*c*) If it was reasonable for the offeree to rely upon the offer being held open and the offeree has altered his position to his detriment in reliance on the offer."

Article 6

86. The text of article 6 of ULF is as follows:

"1. Acceptance of an offer consists of a declaration communicated by any means whatsoever to the offeror.

"2. Acceptance may also consist of the despatch of the goods or of the price of any other act which may be considered to be equivalent to the declaration referred to in paragraph 1 of this Article either by virtue of the offer or as a result of practices which the parties have established between themselves or usage."

87. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"(1) An offer is accepted by a declaration to that effect communicated by any means whatsoever to the offeror.

"(2) The offer is also accepted if the offeree:

"(*a*) Without delay ships either conforming or non-conforming goods unless the offeree notifies the offeror that the shipment of non-conforming goods is offered only for his accommodation; or

"(*b*) Pays the price in accordance with the terms of the offer; or

"(*c*) Commences any other act which indicates that the offer has been accepted; or

"(*d*) Remains silent beyond the point of time when, because of the circumstances of the case, the practices the parties have established between themselves or usage, the offeree should have notified the offeror that he did not intend to accept.

"(3) Where the offer is accepted by the shipment of the goods, payment of the price or the commencement of performance, an offeror who is not notified of the acceptance within a reasonable time may recover any damages caused thereby.

"(4) (*a*) A contract is concluded at the moment the offer is accepted.

"(*b*) A contract of sale may be found to be concluded even though the moment that it was concluded is undetermined."

The provisions in general

88. The Working Group agreed to proceed on the basis of the alternative text although a number of representatives expressed a preference for article 6 of ULF.

Article 6 paragraph (1)

89. The view was expressed that the rule of article 6 (1) coupled with the provision in article 12 on "communication", which results in the offer being accepted on the receipt of the acceptance, should be reversed so that the offer was accepted on despatch. It was decided, however, to retain the receipt theory as it had been adopted in ULF, although article 6 (1) itself was deleted for the reasons set out in paragraphs 91 to 98 and paragraphs 116 to 119.

90. It was pointed out that the words "by any means whatsoever" were very broad and could cause difficulty if the offeror had prescribed a particular mode of acceptance. It was also noted that in any case this question was dealt with in article 12 (1).

Article 6 paragraphs (2) (a), (b), (c) *and (3)*

91. It was noted that article 6 (2) dealt with the practical problem of cases where the offeree acted in response to an offer without first declaring his intention to accept. It was observed that even in the absence of this provision, such acts in response to an offer could constitute acceptance through the operation of usages and practices established by the parties.

92. However, there was considerable opposition to the notion that an offer could be accepted even though at the moment of acceptance no notice had been given to the offeror. Article 6 (3), which would give the offeror a right to damages for any losses caused to him by the offeree's failure to notify him of the acceptance by shipment or other act described in article 6, paragraph (2) (*a*) to (*c*), was considered an inadequate solution since it would place the burden of litigation on an innocent offeror. Accordingly, it was considered that an acceptance should not be considered to be effective until the offeror had received an indication of the offeree's assent to the offer.

93. On the other hand the view was expressed that an offeror should not be able to revoke his offer once the goods were shipped or the price had been paid. Such a result was achieved by a rule that the offer was accepted by the shipment of the goods or payment of the price, as provided in article 6 (2).

94. In relation to article 6 (2) (*a*), under one view shipment of non-conforming goods should not constitute acceptance. However, under another view this was an appropriate result if the goods were despatched with the intention to conform to the offer.

95. It was agreed that the words "without delay" should be deleted so as to eliminate a conflict with the provisions of article 8 on the time during which an offer can be accepted.

96. There was opposition to article 6 (2) (*c*) on the basis that the provision was vague and could apply where such a result would be unreasonable.

97. In the light of this discussion the Working Group decided to delete article 6, paragraphs (2) (*a*), (*b*), (*c*) and (3) and to add to the first sentence of article 5 (2) the words "shipped the goods or paid the price". These words were placed in square brackets for reconsideration by the Working Group at its next session. Under this new text the offer would become irrevocable once the goods were shipped or the price was paid but the acceptance of the offer would depend on notification to the offeror.

98. In order to redraft the provisions on acceptance to conform to this new arrangement, the Working Group created a Drafting Group consisting of the representatives of Hungary, the Philippines and the United States to present a new text. As a result of their proposal, which is discussed in more detail in paragraphs 116 to 119 in relation to article 8, article 6 (1), (2) (*a*), (*b*), (*c*) and (3) were deleted.

Article 6 paragraph (2) (d)

99. There was general agreement to delete article 6 (2) (*d*) on the basis that a contract should be concluded only on notification to the offeror, as discussed above. However, a representative and an observer stated that the same result as in article 6 (2) (*d*) would result through the operation of usages or established practices.

Article 6 paragraph (4)

100. The Working Group agreed that, since a number of provisions in the text and in the draft Convention on the International Sale of Goods have rules which are based on the time the contract was concluded, it was desirable to have a provision which specified that time. It was also agreed that, in order to conform to the new text of article 8, the time of the conclusion of the contract should be the moment at which the acceptance became effective.

101. The Working Group considered and rejected a proposal that the provision also expressly determine the place at which the contract was concluded. It was noted by some that such a provision was unnecessary since the time that the contract was concluded would also determine the place at which the contract was concluded. Others observed that it was undesirable to link automatically the time of conclusion of the contract with the place at which the contract was concluded since there may be little real connexion between the two, particularly in the case of oral contracts or contracts concluded at a place other than the place of business of either party, such as at a trade fair. The consequence of fixing the place of conclusion of the contract may have, it was thought, unfortunate results in regard to conflicts of law and judicial jurisdiction. It was also pointed out that such a provision was unneeded since neither the draft CISG nor this draft text on formation of contracts contained any provisions dependent upon the place at which the contract was concluded.

102. The Working Group deleted article 6 (4) (*b*) of the alternative text since it was considered that such a provision was unnecessary.

103. The text of article 6 as adopted by the Working Group is as follows:

"A contract of sale is concluded at the moment that an acceptance of an offer is effective in accordance with the provisions of this Convention."

The Working Group noted that this text was no longer in the proper sequence and that at a later time it should be moved to a different location.

Article 7

104. The text of article 7 of ULF is as follows:

"1. An acceptance containing additions, limitations or other modifications shall be a rejection of the offer and shall constitute a counter-offer.

"2. However, a reply to an offer which purports to be an acceptance but which contains additional or different terms which do not materially alter the terms of the offer shall constitute an acceptance unless the offeror promptly objects to the discrepancy; if he does not so object, the terms of the contract shall be the terms of the offer with the modifications contained in the acceptance."

105. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"(1) A reply to an offer containing additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.

"(2) (*a*) However, a reply to an offer which purports to be an acceptance but which contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance unless the offeror objects to the discrepancy without delay. If he does not so object, the terms of the contract are the terms of the offer with the modifications contained in the acceptance.

"(*b*) If the offer and a reply which purports to be an acceptance are on printed forms and the non-printed terms of the reply do not materially alter the terms of the offer, the reply constitutes an acceptance of the offer even though the printed terms of the reply materially alter the printed terms of the offer unless the offeror objects to any discrepancy without delay. If he does not so object the terms of the contract are the non-printed terms of the offer with the modifications in the non-printed terms contained in the acceptance plus the printed terms on which both forms agree.

"(3) If a confirmation of a prior contract of sale is sent within a reasonable time after the conclusion of the contract, any additional or different terms in the confirmation [which are not printed] become part of the contract unless they materially alter it, or notification of objection to them is given without delay after receipt of the confirmation. [Printed terms in the confirmation form become part of the contract if they are expressly or impliedly accepted by the other party.]"

Discussion and decision

106. There was general agreement to proceed on the basis of the alternative text.

Article 7 paragraph (1)

107. The Working Group decided to retain this provision which stated the generally accepted rule that a purported acceptance which adds to, limits or otherwise modifies an offer is a rejection of that offer and constitutes a counter-offer.

Article 7 paragraph (2)

108. It was pointed out that paragraph (2) (*a*) contained a practical rule which permitted the formation of a contract even though there were minor discrepancies between the offer and the acceptance.

109. However, several representatives expressed reservations in respect of this provision because it contradicted the basic principle expressed in paragraph (1). It was pointed out that while this rule may be appropriate for national law it was unsuited to international trade where opinions on what would constitute a material alteration would differ widely. Accordingly, the Working Group decided to place article 7 (2) (*a*) in square brackets for further consideration at its next session.

110. As to the provisions set forth in article 7 (2) (*b*), the view was expressed that these provisions dealt with a practical problem and provided an acceptable solution thereto. However, the Working Group, after deliberation, concluded that, if an acceptance contained any material alterations to an offer, it should constitute a rejection of that offer, whether those material alterations were in the printed or in the non-printed terms of the acceptance. Accordingly, the Working Group agreed to delete this provision.

Article 7 paragraph (3)

111. It was pointed out that paragraph (3) was a useful provision as it dealt with the widespread practice of sending a confirmation notice after the conclusion of a contract by telephone, telex or the like. In such confirmation forms it was common to refer to general conditions of sale which contained provisions which had not been discussed by the parties. It was observed that such general conditions were also found in invoices.

112. On the other hand, there was opposition to this proposal for the same reasons as were expressed in relation to paragraph (2) (*b*). The Working Group accordingly decided to place this provision in square brackets and to reconsider it at a later stage.

113. Therefore, the text of article 7 as approved by the Working Group is that contained in paragraphs (1), (2) (*a*) and (3) of the alternative text with paragraph (2) (*a*) and (3) in square brackets.

Article 8

114. The text of article 8 of ULF is as follows:

"1. A declaration of acceptance of an offer shall have effect only if it is communicated to the offeror within the time he has fixed or, if no such time is fixed, within a reasonable time, due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror, and usage. In the case of an oral offer, the acceptance shall be immediate, if the circumstances do not show that the offeree shall have time for reflection.

"2. If a time for acceptance is fixed by an offeror in a letter or in a telegram, it shall be presumed to begin to run from the day the letter was dated or the

hour of the day the telegram was handed in for despatch.

"3. If an acceptance consists of an act referred to in paragraph 2 of Article 6, the act shall have effect only if it is done within the period laid down in paragraph 1 of the present Article."

115. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"(1) Subject to article 9, an offer is accepted only if the declaration of acceptance is communicated to the offeror or any act referred to in article 6(2) is performed within the time the offeror has fixed or, if no time is fixed, within a reasonable time, due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror. In the case of an oral offer, the acceptance must be immediate unless the circumstances show that the offeree is to have time for reflection.

"(2) A period of time for acceptance fixed by an offeror in a telegram or a letter begins to run from the hour of the day the telegram is handed in for despatch or from the date shown on the letter or, if no such date is shown, from the date shown on the envelope. A period of time for acceptance fixed by an offeror in a telephone conversation, telex communication or other means of instantaneous communication, begins to run from the hour of the day that the offer is communicated to the offeree.

"(3) If the last day of such period is an official holiday or a non-business day at the residence or place of business of the offeror, the period is extended until the first business day which follows. Official holidays or non-business days occurring during the running of the period of time are included in calculating the period."

Article 8 paragraph (1)

116. As a result of the decisions in respect of articles 5 and 6, the Drafting Group consisting of the representatives of Hungary, the Philippines and the United States recommended that article 8(1) be redrafted into three new paragraphs as follows:

"(1) A declaration or other conduct by the offeree indicating assent to an offer is an acceptance.

"(1 *bis*) Acceptance of an offer is not effective unless notice of acceptance is communicated to the offeror within the time the offeror has fixed or if no time is fixed, within a reasonable time, due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror. In the case of an oral offer, the acceptance must be immediate unless the circumstances show that the offeree is to have time for reflection.

"(1 *ter*) If an offer is irrevocable because of an act referred to in paragraph 2 of article 5, the acceptance is not effective unless it is given immediately after that act and within the period laid down in paragraph 1 *bis* of the present article."

117. An objection was raised to this proposal that it artificially separated the definition of an acceptance in Article 8(1) from the time the acceptance was effective in article 8(1 *bis*) and 8(1 *ter*). It was suggested that only a declaration should constitute an acceptance. It was also suggested that article 8(1) and 8(1 *ter*) were in contradiction with one another because article 8(1) referred to conduct in general whereas article 8(1 *ter*) referred only to shipment of the goods and payment of the price. Furthermore, it was suggested, the words "or other conduct" created unnecessary complications and should either be deleted or modified. As a result, the Working Group decided to place the words "or other conduct" in article 8(1) and all of article 8(1 *ter*) in square brackets for further consideration at its next session.

118. In article 8(1 *bis*) the words "notice of acceptance" were replaced by "indication of assent" to make it clear that the offeror could be notified of the acceptance by a third party, such as a bank through whom the payment had been made. The words "due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror" were placed in square brackets because it was thought that they were not necessary to explain what is meant by a reasonable time. Other editorial changes were made prior to final adoption.

119. It was explained that article 8(1 *ter*) was included in the recommendation of the Drafting Group because it was thought that in case of a revocable offer which was made irrevocable by shipment of the goods or payment of the price, the offeror should be notified of this action promptly so that he would not be left for any appreciable period of time in the position that his offer was irrevocable although he did not know this fact. It was suggested that this problem did not arise in cases of payment, since notification to the offeror would be given by the bank through which payment was made.

Article 8 paragraph (2)

120. The Working Group decided to adopt the alternative text.

121. It was pointed out that it was useful to provide that time for acceptance commences to run from the date shown on the letter as this was easily provable and generally corresponded to the intention of the offeror. In addition, both parties are aware of the date shown on the letter whereas normally only the offeree would be aware of the date of a postmark on the letter containing the offer. However, several representatives reserved their position in respect of this paragraph on the basis that time for acceptance should commence to run from the date of receipt of the offer.

Article 8 paragraph (3)

122. The Working Group adopted the general approach of the alternative text and referred it to a Drafting Party consisting of the representatives of Czechoslovakia and the United States to redraft the paragraph to make it clear that only official holidays which would prevent an acceptance becoming effective should be included. Two representatives reserved their position in respect to the rule contained in this paragraph.

Decision

123. The text of article 8 as adopted by the Working Group is as follows:

"(1) A declaration [or other conduct] by the offeree indicating assent to an offer is an acceptance.

"(1 *bis*) Acceptance of an offer becomes effective at the moment the indication of assent is commu-

nicated to the offeror. It is not effective if the indication of assent is not communicated within the time the offeror has fixed or if no time is fixed, within a reasonable time [, due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror]. In the case of an oral offer, the acceptance must be immediate unless the circumstances show that the offeree is to have time for reflection.

"[1 *ter*) If an offer is irrevocable because of shipment of the goods or payment of the price as referred to in paragraph 2 of article 5, the acceptance is effective at the moment notice of that acceptance is communicated to the offeror. It is not effective unless the notice is given promptly after that act and within the period laid down in paragraph 1 *bis* of the present article.]

"(2) A period of time for acceptance fixed by an offeror in a telegram or a letter begins to run from the hour of the day the telegram is handed in for despatch or from the date shown on the letter or, if no such date is shown, from the date shown on the envelope. A period of time for acceptance fixed by an offeror in a telephone conversation, telex communication or other means of instantaneous communication, begins to run from the hour of the day that the offer is communicated to the offeree.

"(3) If the notice of acceptance cannot be delivered at the address of the offeror due to an official holiday or a non-business day falling on the last day of such period at the place of business of the offeror, the period is extended until the first business day which follows. Official holidays or non-business days occurring during the running of the period of time are included in calculating the period."

Article 9

124. The text of article 9 of ULF is as follows:

"1. If the acceptance is late, the offeror may nevertheless consider it to have arrived in due time on condition that he promptly so informs the acceptor orally or by despatch of a notice.

"2. If however the acceptance is communicated late, it shall be considered to have been communicated in due time, if the letter or document which contains the acceptance shows that it has been sent in such circumstances that if its transmission had been normal it would have been communicated in due time; this provision shall not however apply if the offeror has promptly informed the acceptor orally or by despatch of a notice that he considers his offer as having lapsed."

125. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"If a reply to an offer which purports to be an acceptance or any act referred to in article 6 (2) is communicated or performed late but the reply or the performance was made in good faith, the offer is deemed to be accepted in due time unless without delay after the offeror learns of the acceptance he informs the offeree that the offer had lapsed."

Discussion and decision

126. The Working Group decided to proceed on the basis of ULF although there was support for the alternative text which, it was stated, provided a unified solution to a practical problem. On the other hand, it was noted that the alternative text depended upon the concept of "good faith", the application of which in relation to a late acceptance was unclear and could be the source of difficulty. Furthermore, it was stated, if an acceptance was sent in such time that it would normally arrive late, the offeror should not be bound to a contract unless he expressed his assent.

127. There was general agreement for the retention of article 9 (1) which reflected the traditional rule that a late acceptance constituted a counter-offer. It was noted that article 9 (1) differed slightly from the traditional approach in that the offeror's assent was effective on the despatch of a notice.

128. There was some difference of opinion in relation to article 9 (2). Under one view it should be deleted because determining whether a communication should have arrived in due time was difficult. In addition, deletion of the paragraph would consistently place the risk of transmission on the acceptor.

129. However, under another view article 9 (2) should be retained because it provided equal protection to both parties. One representative was opposed to taking any decision on the question until the Working Group had determined the time at which the contract was concluded.

130. Under yet another view the second part of article 9 (2) should be deleted.

131. The Working Group decided to place article 9 (2) in square brackets for further consideration at its next session.

Article 10

132. The text of article 10 of ULF is as follows:

"An acceptance cannot be revoked except by a revocation which is communicated to the offeror before or at the same time as the acceptance."

133. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"An acceptance cannot be revoked except by a declaration which is communicated to the offeror before or at the same time the declaration of acceptance is communicated to the offeror or, in the case of an acceptance by an act referred to in article 6 (2), before or at the same time as the offeror is informed of the acceptance."

Discussion and decision

134. In view of the deletion of article 6 (2) the Working Group decided to adopt article 10 of ULF rather than the alternative text. However, the Working Group added the words "becomes effective" at the end of article 10 to bring the text into line with article 8 (2) as it was redrafted by the Working Group.

135. Two representatives expressed their reservations in respect of article 10. In their view, once a contract was concluded by an acceptance, it was not open to one of the parties to abrogate the contract unilaterally.

Article 11

136. The text of article 11 of ULF is as follows:

"The formation of the contract is not affected by the death of one of the parties or by his becoming incapable of contracting before acceptance unless the contrary results from the intention of the parties, usage or the nature of the transaction."

137. The alternative texts proposed by the Secretariat (annex II, appendix I) are as follows:

Proposed alternative text 1

"(1) (Same as article 11 of ULF.)

"(2) If bankruptcy or similar proceedings are opened in respect of either party after the making of the offer, a revocable offer cannot be accepted. However, an irrevocable offer can be accepted during the period the offer is irrevocable."

Proposed alternative text 2

"If either party dies or becomes physically or mentally incapable of contracting or if bankruptcy or similar proceedings are opened in respect of either party after the making of the offer, a revocable offer cannot be accepted. However, an irrevocable offer can be accepted during the period the offer is irrevocable."

Discussion and decision

138. The Working Group decided to proceed on the basis of article 11 of ULF because it was considered that it would be inappropriate to attempt to unify widely differing national bankruptcy rules in the context of the present draft Convention.

139. It was generally considered that, although article 11 was not overly important in the context of international trade, its retention was useful since it resolved a problem that was dealt with unsatisfactorily in a number of legal systems.

140. However, several representatives proposed the deletion of article 11 and another proposed that the provision read as follows:

"The offer becomes ineffective upon the death or incapacity of the offeror and before the offer is accepted. However, an irrevocable offer can be accepted during the period the offer is irrevocable."

The Working Group did not retain this proposal.

141. The Working Group agreed that the wording of article 11 be slightly amended to read ". . . or by his becoming physically or mentally incapable of contracting . . .". This made it clear that the provision applied only to physical persons and did not deal with bankruptcy or similar proceedings. Two representatives and an observer considered that a reference to death and mental incapacity would have been sufficient to make this point clear.

142. The Working Group also added the words "becomes effective" after "acceptance" in order to make the provision conform to article 8.

143. The text of article 11 as adopted by the Working Group is as follows:

"The formation of the contract is not affected by the death of one of the parties or by his becoming physically or mentally incapable of contracting before the acceptance becomes effective unless the contrary results from the intention of the parties, usage or the nature of the transaction."

Article 11A

144. The text of article 11A as proposed by the Secretariat (annex II, appendix I) is as follows:

Alternative 1

"(1) A revocable offer may be assigned by the offeree unless within a reasonable time after the offeror learns of the assignment he notifies either the offeree or the assignee that he objects to it.

"(2) An irrevocable offer may be assigned by the offeree to the extent that, if the contract was concluded, his rights and obligations under the contract could be assigned under the applicable law.

"(3) The contract concluded by acceptance of the offer by the assignee arises only between the offeror and the assignee. However, the offeree is responsible for any failure to perform by the assignee if within a reasonable time after the offeror learns of the assignment he informs the offeree of his intention to hold him so responsible."

Alternative 2

"(1) An offer may be assigned by the offeree unless within a reasonable time after the offeror learns of the assignment he notifies either the offeree or the assignee that he objects to it.

"(2) The contract concluded by acceptance of the offer by the assignee arises only between the offeror and the assignee. However, the offeree is responsible for any failure to perform by the assignee if within a reasonable time after the offeror learns of the assignment he informs the offeree of his intention to hold him so responsible."

Alternative 3

"(1) An offer may be assigned by either the offeror or the offeree unless within a reasonable time after the other party learns of the assignment that party notifies the assignor or the assignee that he objects to it.

"(2) The contract concluded by acceptance of the offer arises only between the offeror and the assignee of the offeree or between the offeree and the assignee of the offeror, as the case may be. However, the assignor is responsible for any failure to perform by the assignee if within a reasonable time after the other party learns of the assignment he informs the assignor of his intention to hold him so responsible."

Discussion and decision

145. The Working Group deleted this provision. The Working Group considered that offers should not be automatically assignable because the offeror should have control over who could accept his offer.

146. Some representatives pointed out that in their legal systems the reorganization of an offeree would not affect the identity of that offeree who could accordingly accept offers addressed to it under its prior name. Other representatives noted that even in the case of mere reorganization it was useful to require that the change be notified to the offeror who could then indicate whether he was prepared to deal with the reorganized entity.

Article 12

147. The text of article 12 of ULF is as follows:

"1. For the purposes of the present Law, the expression 'to be communicated' means to be delivered at the address of the person to whom the communication is directed.

"2. Communications provided for by the present Law shall be made by the means usual in the circumstances."

148. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"For the purposes of this Convention an offer, declaration of acceptance or any other notice is 'communicated' when it is told orally to the party concerned or when it is physically delivered to the addressee or when it is [physically, mechanically or electronically] delivered to his place of business, mailing address or habitual residence."

Discussion and decision

149. The Working Group decided to proceed on the basis of the Secretariat draft.

150. The Working Group accepted a proposal that the words in square brackets be deleted and be replaced by a general expression which would enable the provision to apply to any means of communication that might be developed in the future. The Working Group also accepted a proposal for the simplification of the text and for its location near the start of the draft Convention.

151. The text of article 12 as adopted by the Working Group is as follows:

"For the purposes of this Convention an offer, declaration of acceptance or any other indication of intention is 'communicated' to the addressee when it is made orally or delivered by any other means to him, his place of business, mailing address or habitual residence."

Article 13

152. The text of article 13 of ULF is as follows:

"1. Usage means any practice or method of dealing, which reasonable persons in the same situation as the parties usually consider to be applicable to the formation of their contract.

"2. Where expressions, provisions or forms of contract commonly used in commercial practice are employed, they shall be interpreted according to the meaning usually given to them in the trade concerned."

153. The alternative text proposed by the Secretariat (annex II, appendix I) is as follows:

"Usage means any practice or method of dealing of which the parties knew or had reason to know and which in international trade is widely known to and regularly observed by parties to contracts of the type involved in the particular trade concerned."

Discussion and decision

154. The Working Group adopted the alternative text, which is based on article 8 in the draft CISG. One representative expressed a reservation in respect of the use of the expression "of which the parties knew or had reason to know".

Article 14

155. During the discussion on article 4 the Working Group decided to eliminate article 4 (2) on the interpretation of an offer and requested the Secretariat to prepare a draft text on interpretation based upon articles 4 (2) and 5 (2) of ULF and articles 3, 4 and 5 of the draft Law for the Unification of Certain Rules relating to Validity of Contracts of International Sale of Goods. The draft text prepared in accordance with those instructions is as follows:

"(1) [Communications by and acts of] the parties are to be interpreted according to their actual common intent where such an intent can be established.

"(2) If the actual common intent of the parties cannot be established, [communications by and acts of] the parties are to be interpreted according to the intent of one of the parties, where such an intent can be established and the other party knew or ought to have known what that intent was.

"(3) If neither of the preceding paragraphs is applicable, [communications by and acts of the parties] are to be interpreted according to the intent that reasonable persons would have had in the same circumstances.

"(4) The intent of the parties or the intent a reasonable person would have had in the same circumstances or the duration of any time-limit or the application of article 11 [may] [is to] be determined in the light of the circumstances of the case including the [preliminary] negotiations, any practices which the parties have established between themselves, any conduct of the parties subsequent to the conclusion of the contract, usages [of which the parties knew or had reason to know and which in international trade are widely known to, and regularly observed by parties to contracts of the type involved in the particular trade concerned] and any applicable legal rules for contracts of sale.

"(5) Such circumstances are to be considered, even though they have not been embodied in writing or in any special form. In particular, they may be proved by witnesses."

Discussion and decision

156. The Working Group agreed that a provision on interpretation was important and should be included in the draft text. However, in view of the lack of time to discuss fully all the important issues raised by this text, and because other important matters of interpretation had not been included in this text, the Working Group decided to place the provision in square brackets and to record the principal points of view expressed during the discussion.

157. Several representatives expressed reservations to the draft provisions because they appeared to govern interpretation of a contract once concluded as well as with questions of interpretation in the formation of contracts. Other representatives considered that it was artificial to limit the draft provisions to the formation of contracts and that, on the contrary, both this draft and CISG should contain rules on interpretation, which rules should be identical.

158. It was suggested that the practical effect of these provisions would be easier to understand if the

Secretariat were to prepare a commentary on this article that included practical examples for the next session of the Working Group.

Article 14 paragraph (1)

159. The use of the expression "actual common intent" was objected to as it might be taken to encompass the use of a subjective test in order to determine whether a contract had been formed. It was also suggested that this expression was not suitable for the interpretation of unilateral acts such as offer.

160. The Working Group decided to include in square brackets the expression "statements and declarations" after the word "communications" in paragraphs (1), (2) and (3) to indicate that "communications" also included informal statements of intention.

Article 14 paragraph (2)

161. Under one view the intention of one party should not be able to control the interpretation of a contract. However, under another view, if one party knew the intention of the other party, he should be bound by that intention unless he openly objected to it.

162. It was suggested that under this provision silence might constitute acceptance should one party have that intention and the other party knew of it. An objection was raised to this provision, if such an interpretation was correct.

163. The suggestion was made that the words "or ought to have known what that intent was" rendered the provision objective rather than subjective and that such questions would be better treated in paragraph (3).

Article 14 paragraph (3)

164. The use of the words "reasonable persons" was objected to and it was noted that they did not appear in CISG.

Article 14 paragraph (4)

165. It was suggested that the words in square brackets after "usages" be deleted as "usage" was defined in article 13. However, it was observed that the definition of usages should be fully defined in the provision on interpretation since it was in this provision that "usages" had their greatest operative effect.

166. The Working Group agreed to delete as unnecessary the expression "and any applicable legal rules for contracts of sale" in paragraph (4).

167. The use of the words "any conduct of the parties subsequent to the conclusion of the contract" was objected to on the grounds that acts after the conclusion of the contract should not be relevant to questions of interpretation as to whether a contract was concluded.

Article 14 paragraph (5)

168. The Working Group decided to delete paragraph (5) because it was felt not to be necessary.

II. Future Work

169. The Working Group, in view of the progress made at its present session, was agreed that it was likely to complete its mandate with respect to the matters of formation and validity of contracts, in the course of one further session. In order to enable the Commission to consider the draft Convention on Formation and Validity of Contracts at its eleventh session in 1978, together with comments from Governments and interested organizations on the draft Convention, the Working Group decided to recommend to the Commission that the Group should hold its ninth session in Geneva from 19–30 September 1977. However, in case the Working Group would not be able to complete its work at that session, the Working Group decided to request the Commission to schedule a further tenth session in New York in January 1978, even though it noted that it may be difficult for some representatives to attend so many meetings. Such an arrangement would make it possible for the Commission, should it so desire, to recommend to the General Assembly to convene in 1980 a conference of plenipotentiaries at which both the draft Convention on the International Sale of Goods and the draft Convention in respect of the Formation and Validity of Contracts would be considered.

170. One representative doubted whether the Working Group could complete its mandate with regard to matters of formation and validity of contracts in two further sessions if it gave a careful consideration to the full range of questions relating to validity of contracts. He further noted that such a result would have financial implications and may delay completion of work on the Convention on the International Sale of Goods contrary to the prevailing approach shown during the course of discussions in the Sixth Committee when it considered the report of the Commission on the work of its ninth session.[9]

171. The Working Group noted that the Commission at its ninth session had decided to take up at its tenth session the question whether the rules on formation and validity of contracts should be set forth in the Convention containing the rules on the International Sale of Goods or whether they should form the subject of a separate convention, and whether, if it were decided that there should be two separate conventions, they should be considered at the same conference of plenipotentiaries. It was observed that the discussion which the Commission intended to have on these matters would make clear the following issues: whether one conference should be convened to consider (i) only the draft Convention on the International Sale of Goods, or (ii) both the draft Convention on the International Sale of Goods and the draft Convention on the Formation of Contracts, or (iii) the draft Convention on the International Sale of Goods and separate draft Conventions on Formation of Contracts and Validity of Contracts; or whether two or more conferences of plenipotentiaries should be convened to consider these conventions separately. In this connexion the Working Group requested the Secretariat to prepare a statement of financial implications for each of these alternatives and to submit it to the tenth session of the Commission.

172. The Working Group also decided to recommend to the Commission that upon the completion of its mandate, the Secretary-General be requested (i) to circulate the draft Convention to Governments and interested international organizations for comments and to prepare a critical analysis of those comments to be submitted to the Commission at its eleventh session; (ii) to

[9] Sixth Committee report, A/31/390, para. 15 (reproduced in this volume, part one, I, B).

circulate the draft of a law for the unification of certain rules relating to validity of contracts of international sale of goods prepared by the International Institute for the Unification of Private Law (UNIDROIT) to Governments and interested international organizations for their comments as to whether any matters in that text which had not been included in the draft Convention prepared by the Working Group should be included.

173. The Working Group decided that at its next session it should determine which rules on validity of contracts of international sale of goods should be included in the draft Convention and to complete, if possible, its work in respect of the revision of the Uniform Law on the Formation of Contracts for the International Sale of Goods and its work on validity of such contracts.

174. In preparation of that session the Secretariat was requested to analyse the UNIDROIT text and to suggest, with draft texts as necessary, what matters covered by that text as well as what other matters of validity of contract should be included in the draft Convention. The Working Group invited any representatives or observers to submit their views to the Secretariat on the matter. The Secretariat was also requested to review the text of ULF as approved by the Working Group at this session and to suggest to the Working Group the modifications which might be made in the text in the various language versions to render the style of drafting consistent, to suggest a reorganization of the provisions in a more logical order and to prepare titles for the individual articles. The Working Group also requested the Secretariat to prepare a commentary on the text as it had been approved by the Working Group at this session similar to the commentary which had been prepared on the draft Convention on the International Sale of Goods.

B. Draft Convention on the formation of contracts for the international sale of goods as approved or deferred for further consideration by the Working Group on the International Sale of Goods at its eighth session[1] (A/CN.9/128, annex I)*

[*Article one (alternative No. 1)*

This Convention applies to the formation of contracts of sale of goods which, if they were concluded, would be governed by the Convention on the International Sale of Goods.]

[*Article one (alternative No. 2)*

(1) This Convention applies to the formation of contracts of sale of goods entered into by parties whose places of business are in different States:

(*a*) When the States are Contracting States; or

(*b*) When the rules of private international law lead to the application of the law of a Contracting State.

(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the offer, any reply to the offer, or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.

(3) This Convention does not apply to the formation of contracts of sale:

(*a*) Of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, did not know and had no reason to know that the goods were bought for any such use;

(*b*) By auction;

(*c*) On execution or otherwise by authority of law;

(*d*) Of stocks, shares, investment securities, negotiable instruments or money;

(*e*) Of ships, vessels or aircraft;

(*f*) Of electricity.

(4) This Convention does not apply to the formation of contracts in which the predominant part of the obligations of the seller consists in the supply of labour or other services.

(5) The formation of contracts for the supply of goods to be manufactured or produced is to be considered as the formation of contracts of sale of goods unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production.

(6) For the purposes of this Convention:

(*a*) If a party has more than one place of business, the place of business is that which has the closest relationship to the proposed contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract;

(*b*) If a party does not have a place of business, reference is to be made to his habitual residence;

(*c*) Neither the nationality of the parties nor the civil or commercial character of the parties or of the proposed contract is to be taken into consideration.]

Article 2

(1) The parties may [agree to] exclude the application of this Convention.

(2) Unless the Convention provides otherwise, the parties may [agree to] derogate from or vary the effect of any of its provisions as may appear from the preliminary negotiations, the offer, the reply, the practices which the parties have established between themselves or usages.

(3) However, a term of the offer stipulating that silence shall amount to acceptance is invalid.

[*Article 3 (alternative No. 1)*

An offer or an acceptance need not be evidenced by writing and shall not be subject to any other requirement as to form. In particular, they may be proved by means of witnesses.]

* 3 February 1977.

[1] Those matters which are still unresolved by the Working Group are in square brackets.

[*Article 3 (alternative No. 2)*

Neither the formation or validity of a contract nor the right of a party to prove its formation or any of its provisions depends upon the existence of a writing or any other requirement as to form. The formation of the contract, or any of its provisions, may be proved by means of witnesses or other appropriate means.]

Article 3A

(1) The contract may be modified or rescinded merely by agreement of the parties.

(2) A written contract which contains a provision requiring any modification or rescission to be in writing may not be otherwise modified or rescinded. [However, a party may be precluded by his action from asserting such a provision to the extent that the other party has relied to his detriment on that action.]

Article 4

(1) 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 offeror to be bound in case of acceptance.

(2) An offer is sufficiently definite if expressly or impliedly it indicates the kind of goods and fixes or makes provision for determining the quantity and the price. [Nevertheless, if the offer indicates the intention to conclude the contract even without making provision for the determination of the price, it is considered as a proposal that the price be that generally charged by the seller at the time of the conclusion of the contract or, if no such price is ascertainable, the price generally prevailing at the aforesaid time for such goods sold under comparable circumstances.]

Article 5

(1) The offer becomes effective when it has been communicated to the offeree. It can be withdrawn if the withdrawal is communicated to the offeree before or at the same time as the offer [even if it is irrevocable].

(2) The offer can be revoked if the revocation is communicated to the offeree before he has dispatched his acceptance [, shipped the goods or paid the price].

(3) However, an offer cannot be revoked:

(*a*) if the offer expressly or impliedly indicates that it is firm or irrevocable; or

(*b*) if the offer states a fixed period of time for [acceptance] [irrevocability]; or

(*c*) if it was reasonable for the offeree to rely upon the offer being held open and the offeree has altered his position to his detriment in reliance on the offer.

Article 6

A contract of sale is concluded at the moment that an acceptance of an offer is effective in accordance with the provisions of this Convention.

Article 7

(1) A reply to an offer containing additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.

[(2) However, a reply to an offer which purports to be an acceptance but which contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance unless the offeror objects to the discrepancy without delay. If he does not so object, the terms of the contract are the terms of the offer with the modifications contained in the acceptance.]

[(3) If a confirmation of a prior contract of sale is sent within a reasonable time after the conclusion of the contract, any additional or different terms in the confirmation [which are not printed] become part of the contract unless they materially alter it, or notification of objection to them is given without delay after receipt of the confirmation. [Printed terms in the confirmation form become part of the contract if they are expressly or impliedly accepted by the other party.]]

Article 8

(1) A declaration [or other conduct] by the offeree indicating assent to an offer is an acceptance.

(1 *bis*) Acceptance of an offer becomes effective at the moment the indication of assent is communicated to the offeror. It is not effective if the indication of assent is not communicated within the time the offeror has fixed or if no time is fixed, within a reasonable time [, due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror]. In the case of an oral offer, the acceptance must be immediate unless the circumstances show that the offeree is to have time for reflection.

[(1 *ter*) If an offer is irrevocable because of shipment of the goods or payment of the price as referred to in paragraph 2 of article 5, the acceptance is effective at the moment notice of that acceptance is communicated to the offeror. It is not effective unless the notice is given promptly after that act and within the period laid down in paragraph 1 *bis* of the present article.]

(2) A period of time for acceptance fixed by an offeror in a telegram or a letter begins to run from the hour of the day the telegram is handed in for despatch or from the date shown on the letter or, if no such date is shown, from the date shown on the envelope. A period of time for acceptance fixed by an offeror in a telephone conversation, telex communication or other means of instantaneous communication, begins to run from the hour of the day that the offer is communicated to the offeree.

(3) If the notice of acceptance cannot be delivered at the address of the offeror due to an official holiday or a non-business day falling on the last day of such period at the place of business of the offeror, the period is extended until the first business day which follows. Official holidays or non-business days occurring during the running of the period of time are included in calculating the period.

Article 9

(1) If the acceptance is late, the offeror may nevertheless consider it to have arrived in due time on condition that he promptly so informs the acceptor orally or by despatch of a notice.

[(2) If however the acceptance is communicated

late, it shall be considered to have been communicated in due time, if the letter or document which contains the acceptance shows that it has been sent in such circumstances that if its transmission had been normal it would have been communicated in due time; this provision shall not however apply if the offeror has promptly informed the acceptor orally or by despatch of a notice that he considers his offer as having lapsed.]

Article 10

An acceptance cannot be revoked except by a revocation which is communicated to the offeror before or at the same time as the acceptance becomes effective.

Article 11

The formation of the contract is not affected by the death of one of the parties or by his becoming physically or mentally incapable of contracting before the acceptance becomes effective unless the contrary results from the intention of the parties, usage or the nature of the transaction.

Article 12

For the purposes of this Convention an offer, declaration of acceptance or any other indication of intention is "communicated" to the addressee when it is made orally or delivered by any other means to him, his place of business, mailing address or habitual residence.

Article 13

Usage means any practice or method of dealing of which the parties knew or had reason to know and which in international trade is widely known to and regularly observed by parties to contracts of the type involved in the particular trade concerned.

Article 14

(1) [Communications, statements and declarations by and acts of] the parties are to be interpreted according to their actual common intent where such an intent can be established.

(2) If the actual common intent of the parties cannot be established, [communications, statements and declarations by and acts of] the parties are to be interpreted according to the intent of one of the parties, where such an intent can be established and the other party knew or ought to have known what that intent was.

(3) If neither of the preceding paragraphs is applicable, [communications, statements and declarations by and acts of the parties] are to be interpreted according to the intent that reasonable persons would have had in the same circumstances.

(4) The intent of the parties or the intent a reasonable person would have had in the same circumstances or the duration of any time-limit or the application of article 11 [may] [is to] be determined in the light of the circumstances of the case including the [preliminary] negotiations, any practices which the parties have established between themselves, any conduct of the parties subsequent to the conclusion of the contract, usages [of which the parties knew or had reason to know and which in international trade are widely known to, and regularly observed by parties to contracts of the type involved in the particular trade concerned].

C. Report of the Secretary-General: formation and validity of contracts for the international sale of goods (A/CN.9/128, annex II)*

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INTRODUCTION

1. At its seventh session (Geneva, 5 to 16 January 1976) the Working Group on the International Sale of Goods requested the Secretariat to prepare, in consultation with UNIDROIT, one or more studies that would:

"(*a*) Submit to a critical analysis the 1964 Hague Uniform Law on the Formation of Contracts for the International Sale of Goods and the UNIDROIT draft law on the validity of contracts of international sale of goods, and

"(*b*) Examine the feasibility and desirability of dealing with both subject-matters in a single instrument" (A/CN.9/116, para. 114; yearbook . . . , 1976, part two, I, 1).

2. This report is issued pursuant to that request. An-

* 3 February 1977.

nex I to the report contains the 1964 Hague Uniform Law on the Formation of Contracts for the International Sale of Goods together with a critical analysis and proposed alternative provisions. Annex II to the report contains the UNIDROIT draft law on the validity of contracts of international sale of goods with a critical analysis.

History of the 1964 Uniform Law on Formation[1]

3. In 1930 the International Institute for the Unification of Private Law (UNIDROIT) appointed a Committee to prepare a draft uniform law of sale. During the deliberations of this Committee problems were encountered in defining the time at which a contract was concluded. Such a definition was attempted because a number of provisions were related to the time and place that the contract was concluded. These problems remained unresolved and accordingly in 1934 UNIDROIT appointed a separate Committee to consider the question of the unification of rules for the formation of contracts. In 1936 that Committee submitted a draft of a uniform law on the formation of international contracts by correspondence. Because of the significant differences which exist between the theories in respect of the formation of contracts in different countries, it was thought that there would be little chance of drafting a satisfactory international convention on the matter. Therefore, the Institute took no further action at that time.

4. At the Diplomatic Conference convened at The Hague in 1951 to examine the draft of a uniform law on the international sale of goods (ULIS), it was felt that new provisions specifying the time at which a contract was concluded should be drafted because of the large number of provisions in the draft law on sales which referred to the time of the conclusion of the contract. It was left to the Special Commission created by the Conference to determine whether the rules on formation of contracts should be included in the main text of the law of sales or whether they should be in a separate text. The Special Commission decided in favour of preparing a separate text.

5. As a result of these actions UNIDROIT appointed a Study Group which prepared a draft of a Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF). This draft law was considered and a final text was adopted at the Diplomatic Conference convened at The Hague in 1964 which considered and adopted ULIS.

6. ULF has been signed by the following States: Greece (3 August 1964); the Kingdom of the Netherlands (12 August 1964); San Marino (24 August 1964); Italy (23 December 1964); Vatican City (2 March 1965); United Kingdom of Great Britain and Northern Ireland (8 June 1965); Belgium (6 October 1965); Federal Republic of Germany (11 October 1965); Luxembourg (7 December 1965); Israel (28 December 1965); France (31 December 1965) and Hungary (31 December 1965). The following States have ratified the Convention: United Kingdom of Great Britain and Northern Ireland (31 August 1967); San Marino (24 May 1968); Belgium (1 December 1970); Italy (22 February 1972); the Kingdom of the Netherlands (for the Kingdom in Europe) (22 February 1972) and the Federal Republic of Germany (also for West Berlin) (16 October 1973). In addition the Gambia acceded to the Convention on 5 March 1974.

7. In conformity with article VIII, paragraph 1, the Convention entered into force on 23 August 1972 for Belgium, Italy, San Marino, the Kingdom of the Netherlands (for the Kingdom in Europe) and the United Kingdom of Great Britain and Northern Ireland. In conformity with article VIII, paragraph 2, the Convention entered into force on 17 April 1974 for the Federal Republic of Germany and on 6 September 1974 for the Gambia.

History of the UNIDROIT draft of a law for the unification of certain rules relating to the validity of contracts of international sale of goods

8. In 1960 UNIDROIT requested the *Max-Planck Institut für auslandisches und internationales Privatrecht* to prepare a comparative study of the pertinent rules on the validity of contracts of sale. After submission of this study in 1963[2] the Max-Planck Institute was asked to prepare a preliminary text of a Uniform Law. A Committee of UNIDROIT considered this text in four sessions held between 1967 and 1971 during which time it formulated the draft of a Law for the Unification of Certain Rules Relating to the Validity of Contracts of International Sale of Goods (LUV). This draft law was approved by the Governing Council of UNIDROIT on 31 May 1972.

Formation and validity of contracts in the Commission

Formation

9. In its report on the work of its second session (1969) the Commission decided that the Working Group on the International Sale of Goods should consider "which modifications of [ULF] might render [it] capable of wider acceptance by countries of different legal, social and economic systems, or whether it will be necessary to elaborate a new text for the same purpose" (A/7618, para. 38, Yearbook . . . , 1968-1970, part two, II, A). In its report on the work of its third session (1970) the Commission decided that the Working Group should give priority to the systematic consideration of ULIS (A/8017, para. 72; Yearbook . . . , 1968-1970, part two, III, A) and should, therefore, postpone its work on the ULF.

Validity

10. In its report on the work of its sixth session (1973) the Commission noted the receipt of a letter from the President of UNIDROIT which transmitted the text of a "draft of a law for the unification of certain rules relating to the validity of contracts of international sale of goods" and which invited the Commission to include the consideration of this draft as an item on its agenda. The Commission decided to consider at its

[1] The drafting history is more fully described in vol. I of the records of the 1964 Diplomatic Conference on the Unification of Law Governing the International Sale of Goods, The Hague, 2 to 25 April 1964, pp. 3-10.

[2] The conditions of substantive validity of contracts of sale, UNIDROIT Year Book 1966, pp. 175-410 (French only).

seventh session what further steps should be taken on the subject (A/9017, para. 148; Yearbook . . . , 1973, part one, II, A).

Formation and validity

11. In its report on the work of its seventh session (1974) the Commission decided to request the Working Group "after having completed its work on the uniform law on the international sale of goods, to consider the establishment of uniform rules governing the validity of contracts for the international sale of goods, on the basis of the . . . UNIDROIT draft, in connexion with its work on uniform rules governing the formation of contracts for the international sale of goods" (A/9617, para. 93; Yearbook . . . , 1974, part one, II, A).

12. In its report on the work of its sixth session (1975) the Working Group decided "to hold at its [seventh] session a preliminary discussion on the formation and validity of . . . contracts [of sale for the international sale of goods] so as to give the Secretariat, if appropriate, directions as to the studies which the Working Group may wish it to undertake in that field" (A/CN.9/100, para. 118; Yearbook . . . , 1975, part two, I, 1).

13. In its report on the work of its seventh session (1976) the Working Group, after deliberation, was of the unanimous view that, at its next session, it should begin work on uniform rules governing the formation of contracts and should make an attempt to formulate such rules on a broader basis than the international sale of goods. If, in the course of its work, it should prove that the principles underlying contracts of sale and other types of contract could not be treated in the same text, the Group would direct its work towards contracts of sale only. The Working Group was further of the view that it should consider whether some or all of the rules on validity could appropriately be combined with rules on formation. The Working Group decided to place these conclusions before the ninth session of the Commission (A/CN.9/116, para. 13; Yearbook . . . , 1976, part two, I, 1).

14. In its report on the work of its ninth session (1976) the Commission decided to instruct the Working Group on the International Sale of Goods to confine its work on the formation and validity of contracts to contracts of the international sale of goods" (A/31/17, para. 28; Yearbook . . . , 1976, part one, II, A).

15. Accordingly the studies prepared by the Secretariat in response to the directions of the Working Group (para. 1 above) deal only with the formation and validity of contracts for the international sale of goods.

Coverage of the proposed convention

16. The subject of the formation and validity of contracts, even if limited to contracts for the international sale of goods, is one which is vast and deeply imbedded in legal theory on the nature of contractual obligations. Fortunately, it is not necessary to codify every aspect of the subject in a text of uniform law since there is more agreement on the practical result in various situations than there is on the theory by which that solution is attained or justified. Therefore, it may be enough to prepare a text which offers solutions to practical problems caused by such differences in the law in various legal systems.

17. For this reason, it is suggested that the draft convention on formation of contracts to be prepared by the Working Group might follow the plan of ULF in regard to its coverage. Such a draft convention would be largely limited to offer and acceptance. These matters are ones in which the differences between the various legal systems are such that practical problems are caused in international trade. Nevertheless, they are subjects in which it appears possible to formulate a generally acceptable text.

18. It is also suggested that the draft convention to be prepared not include any provisions in respect of validity of contracts based on the LUV. The LUV contains 16 articles which cover such matters as interpretation of the acts of the parties, mistake, fraud, duress, impossibility of performance at the time of contracting and avoidance of the contract and other remedies. However, all available evidence suggests that these problems of validity are relatively rare events in respect of contracts for the international sale of goods.

19. As noted in the report of the Max-Planck Institute accompanying the draft text on validity prepared by UNIDROIT, that Institute had contacted a number of commercial institutions, in particular the International Chamber of Commerce, to inquire as to the practical utility and necessity of a unification of the rules on this subject:

> "The virtually unanimous view held by those institutions was that the question of whether an international contract is valid or not arises only in a limited number of cases. Thus it was found that of all published arbitration awards handed down by Dutch arbitration tribunals between 1945 and 1964 only 20 awards discussed problems relating to the substantive validity of a contract. Of the 500 arbitration proceedings conducted under the auspices of the Hamburg Chamber of Commerce only one award hinged on a problem of mistake. There is little doubt that merchants engaged in international sales transactions are much more concerned with problems arising from the non-performance of a contract than with issues relating to its substantive validity."[3]

20. Although the commercial institutions consulted by the Max-Planck Institute were all based in Western Europe and the results reflect, therefore, Western European experience, the Secretariat has no evidence that the experience in other parts of the world is different in respect of the matters covered by LUV. Nor does the Secretariat have any evidence that differences in the laws in respect of these aspects of validity of contracts lead to significant problems in international trade.

21. It is likely that the reason that the problems of validity covered by LUV rarely arise in contracts for the international sale of goods is that such contracts are concluded between merchants who are, at least as compared to the average person, relatively sophisticated in matters of contracting. The problems of mistake, fraud and duress — which are the heart of the LUV — are

[3] Report of the *Max-Planck Institut für auslandisches und internationales Privatrecht*, UNIDROIT Etude XVI/B, Doc. 22, p. 15. (This report will be referred to as the Max-Planck report.) The text of this report was approved by the Governing Council of UNIDROIT on 31 May 1972.

less likely to occur between merchants than they are in transactions between merchants and consumers or between two non-merchants.

22. Moreover, it would seem that when such events do occur, they can usually be handled as well under non-uniform national law as under any proposed text of uniform law. It would seem that the common examples of mistake, fraud or duress which would justify a party to avoid the contract under the LUV would justify that party to avoid the contract under any applicable legal system. To the extent that this is the case, adoption of a uniform law will not increase the uniformity of result for the parties.

23. More importantly, it does not appear that the LUV increases the degree of unification in those areas where there are divergencies in the law between legal systems, and it does not appear that any text could achieve this result.

24. The difficulty arises out of two characteristics of the law governing the validity of contracts. The first such characteristic is that the event which activates the legal rules in a text on the validity of contracts is usually not an objective physical event, but an event which must be characterized by the adjudicator. For example, a rule on offer and acceptance can state that the offer has been accepted when the acceptance arrives at the address of the offeror. Such a rule gives rise to relatively few problems of interpretation. However, article 11 of the LUV provides that the threat which justifies avoidance of the contract must have been "unjustifiable, imminent and serious". Each of these three words admits of extensive interpretation before it can be determined whether the contract can be avoided.

25. The second characteristic of some aspects of the law governing the validity of contracts is that it is an important vehicle by which the political, social and economic philosophy of the particular society is made effective in respect of contracts. This is most obviously the case in respect of rules invalidating a contract because of a violation of a statutory prohibition or of public policy. Statutory prohibitions and public policy vary to such an extent from country to country that it is impossible to achieve the goal of unification, namely the development of a uniform body of case law. Consequently, the UNIDROIT committee decided to omit such a rule from the draft LUV.[4]

26. Similarly, the rules on duress, or similar rules on usury, unconscionable contracts, good faith in performance and the like also serve as a vehicle by which the political, social and economic philosophy of the society is made effective in respect of contracts. It is by the extensive or the restrictive interpretation of such rules that many legal systems have effected the balance between a philosophy of sanctity of contract with the security of transactions which that affords and a philosophy of protecting the weaker party to a transaction at the cost of rendering contracts less secure.

27. For these reasons it is suggested that the draft convention to be prepared not include any provisions in respect of validity of contracts based on the LUV. It may be, however, that the consideration which is currently being given in other bodies of the United Nations system to such issues as the new international economic order and transnational corporations may eventually result in a general consensus on principles which may affect the validity of international contracts. If so, and if such principles should bear on the validity of contracts for the international sale of goods, the Commission may wish to consider these matters. In the absence of a general consensus, the consideration of these matters would appear to be so complex that it would not be feasible for the Working Group to complete its work on the formation of contracts for the international sale of goods "in the shortest possible time", as requested by the Commission during its ninth session (A/31/17, para. 27; Yearbook . . . , 1976, part one, II, A).

[4] Max-Planck report, p. 17.

APPENDIX I

1964 Hague Uniform Law on the Formation of Contracts for the International Sale of Goods:* critical analysis and proposed alternative provisions

ARTICLE 1

Text of ULF in annex I of the 1964 Convention

(1) The present Law shall apply to the formation of contracts of sale of goods entered into by parties whose places of business are in the territories of different States, in each of the following cases:

(*a*) Where the offer or the reply relates to goods which are in the course of carriage or will be carried from the territory of one State to the territory of another;

(*b*) Where the acts constituting the offer and the acceptance are effected in the territories of different States;

(*c*) Where delivery of the goods is to be made in the territory of a State other than that within whose territory the acts constituting the offer and the acceptance are effected.

(2) Where a party does not have a place of business, reference shall be made to his habitual residence.

(3) The application of the present Law shall not depend on the nationality of the parties.

(4) Offer and acceptance shall be considered to be effected in the territory of the same State only if the letters, telegrams or other documentary communications which contain them are sent and received in the territory of that State.

(5) For the purpose of determining whether the parties have their places of business or habitual residences in "different States", any two or more States shall not be considered to be "different States" if a valid declaration to that effect made under Article II of the Convention dated the 1st day of July 1964 relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods is in force in respect of them.

(6) The present Law shall not apply to the formation of contracts of sale:

(*a*) Of stocks, shares, investment securities, negotiable instruments or money;

(*b*) Of any ship, vessel or aircraft, which is or will be subject to registration;

(*c*) Of electricity;

(*d*) By authority of law or on execution or distress.

(7) Contracts for the supply of goods to be manufactured or produced shall be considered to be sales within the meaning of the present Law, unless the party who orders the goods

* The Uniform Law is hereafter referred to as ULF. The English and French language versions of ULF are the official texts as adopted by the 1964 Hague Conference. The Russian and Spanish language versions are unofficial translations reproduced from *Register of Texts of Conventions and other Instruments Concerning International Trade Law*, vol. I (United Nations publication, Sales No. 71.V.3), chap. I, sect. 1.

undertakes to supply an essential and substantial part of the materials necessary for such manufacture or production.

(8) The present Law shall apply regardless of the commercial or civil character of the parties or of the contracts to be concluded.

(9) Rules of private international law shall be excluded for the purpose of the application of the present Law, subject to any provision to the contrary in the said Law.

Text of ULF in annex II of the 1964 Convention

The present Law shall apply to the formation of contracts of sale of goods which, if they were concluded, would be governed by the Uniform Law on the International Sale of Goods.

COMMENTARY

1. The text of article 1 in annex II of the 1964 Convention is for use by those contracting States which are also contracting States to the 1964 Hague Convention relating to a Uniform Law on the International Sale of Goods (ULIS). The text of article 1 in annex I of the 1964 Convention is for use by those contracting States which are not contracting States in regard to ULIS.

2. If a separate Convention on the Formation of Contracts for the International Sale of Goods is prepared by the Working Group, a new draft of article 1 will need to be prepared based on the provisions in the draft convention on the international sale of goods (CISG).

ARTICLE 2

Text of ULF

(1) The provisions of the following articles shall apply except to the extent that it appears from the preliminary negotiations, the offer, the reply, the practices which the parties have established between themselves or usage, that other rules apply.

(2) However, a term of the offer stipulating that silence shall amount to acceptance is invalid.

Proposed alternative text

The provisions of the following articles apply except to the extent that the preliminary negotiations, the offer, the reply, any practices that the parties have established between themselves or usage lead to the application of more stringent legal rules or more stringent agreed principles to determine whether a contract has been concluded.

COMMENTARY

1. Article 2 states the extent to which the parties may vary or derogate from the provisions of this Convention.

2. Article 2 (1) states a general principle of party autonomy. This article is consistent with the general principle of party autonomy found in article 3 of ULIS and article 5 of the draft CISG. However, article 2 (2) limits party autonomy in one respect, i.e., that the offeror may not unilaterally declare in the offer that a contract will be concluded if the offeree remains silent.

3. The proposed alternative text suggests a different approach to the subject of party autonomy in respect of the formation of the contract. The ULF provides the minimum criteria which must be met for a contract to be concluded. However, even if these minimum criteria are met, there is no contract if the parties have agreed that additional criteria must also be met. For example, even though it is not necessary for the parties to agree on such matters as the delivery date or the date of payment of the price for the offer to be sufficiently definite, if one of the parties insists on prior agreement on these points, no contract will be concluded until such agreement is reached.

4. However, under the proposed alternative text the parties may not agree that a contract will be concluded even though all of the necessary elements have not been agreed upon, e.g. if the communication sent with the intent of making an offer is not sufficiently definite in respect of the quantity to be an offer under article 4. An agreement between the parties that the seller would sell "all that the buyer orders" would constitute only an invitation to deal; it could not be considered to be a current contract of sale.

5. It is possible to imagine agreements which a legal system might permit which would cause future contracts to come into existence at an earlier time than the general rules of law would allow. For example, article 6 provides that an acceptance by correspondence is effective only on delivery of the acceptance at the address of the offeror, and, therefore, presumably, the contract is concluded at that time. If the parties were to agree that the contract was concluded on despatch of the acceptance, the State may have no particular reason to refuse to give effect to that agreement. However it is difficult to see why the parties would make such an agreement.

6. If the principle of the proposed alternative text is accepted, there is no need to have a provision, similar to that in article 2 (2) limiting the power of the offeree to stipulate in the offer that silence amounts to acceptance.

ARTICLE 3

Text of ULF

An offer or an acceptance need not be evidenced by writing and shall not be subject to any other requirement as to form. In particular, they may be proved by means of witnesses.

Proposed alternative text

Neither the formation or validity of a contract nor the right of a party to prove its formation or any of its provisions depends upon the existence of a writing or any other requirement as to form. The formation of the contract, or any of its provisions, may be proved by means of witnesses or other appropriate means.

COMMENTARY

1. The substance of article 3 is the same as that in article 15 of ULIS and article 11 of the draft CISG. It should be noted that the Working Group left article 11 of the draft CISG in square brackets to indicate that it was a matter which it considered should be decided by the Commission. It can be assumed that if article 11 is retained in the draft CISG by the Commission, it would be retained in a draft convention on formation. On the other hand, if article 11 is deleted from the draft CISG, the action of the Working Group in respect of article 3 of ULF would depend on whether article 11 was deleted from the draft CISG because the Commission decided that it did not belong in the Convention on the International Sale of Goods or whether it was deleted because the Commission decided that the rule was wrong.

2. It was pointed out in the commentary to article 11 of the draft CISG that even though the provision could be considered to relate to a matter of formation or validity, the fact that many contracts for the international sale of goods are concluded by modern means of communication which do not always involve a written contract led to the decision to include it in the present convention.[a] Nevertheless, any administrative or criminal sanctions for breach of the rules of any State requiring that such contracts be in writing, whether for purposes of administrative control of the buyer or seller, for purposes of enforcing exchange control laws, or otherwise, would still be enforceable against a party which concluded the non-written contract even though the contract itself would be enforceable between the parties.

3. It should be added that a party could make it clear in the preliminary negotiations that no communication is to be regarded as an offer or an acceptance unless it is in writing. The same result might occur because of the practices which the parties have established between themselves or usage. In such

[a] A/CN.9/116, annex II (Yearbook . . . , 1976, part two, I, 3).

cases the requirement of a writing would exist as an incident of the principle of party autonomy as found in article 2.

4. The use of the expression "need not be evidenced by writing" suggests that article 3 regulates only matters of evidence and of the proper form of the offer and the acceptance but that it does not overcome a national rule of law that a contract for the international sale of goods must be in writing either to be validly formed or to be enforceable before the courts of that country. However, the French language versions of article 3 of ULF and article 11 of the draft CISG use the phrase "aucune forme n'est prescrite pour . . ." which suggests that the article goes to questions of validity and enforceability. If article 3 is to be retained in its present form, it may be desirable to unify the translations in the different languages and to draw the attention of the Commission to this problem in relation to article 11 of the draft CISG.

5. The provision that an offer or an acceptance is not subject to "any other requirement as to form" refers to requirements such as the placing of seals on a document, its witnessing or authentication by a notary or the use of special forms.

6. The provision which enables the existence and contents of the offer and the acceptance to be proved by witnesses, is intended to apply to those countries in which the requirement that there be a writing goes to the proof of the existence of the contract rather than to the proper form of the offer and acceptance. It has, however, been suggested that article 3 could be interpreted in such a manner so as not to achieve the desired result in these countries.[b]

7. Although article 3 could be interpreted to mean only that the existence of the offer and acceptance may be proved by means of witnesses, logically it must be understood to mean also that the terms of the offer and acceptance may be proved by means of witnesses. Such a provision has been added to the proposed alternative text.

8. The proposed alternative text seeks to eliminate the difficulties mentioned above. It introduces no new policies beyond those already in article 3. If the Working Group finds the alternative text preferable to article 3 of ULF, it might wish to suggest that article 11 of the draft CISG be modified accordingly. It may be noted that the last four words, "or other appropriate means", have been added to make it clear that not only witnesses but any other appropriate proof, such as the conduct of the parties, may be used to prove the existence of the contract and its terms.

9. A new article 3A has been added in respect of the related problem of the oral modification or rescission of a written contract.

PROPOSED ARTICLE 3A

(1) An agreement by the parties made in good faith to modify or rescind the contract is effective. However, a written contract which excludes any modification or rescission unless in writing cannot be otherwise modified or rescinded.

(2) Action by one party on which the other party reasonably relies to his detriment may constitute a waiver of a provision in a contract which requires any modification or rescission to be in writing. A party who has waived a provision relating to an unperformed portion of the contract may retract the waiver. However, a waiver cannot be retracted if the retraction would result in unreasonable inconvenience or unreasonable expense to the other party because of his reliance on the waiver.

[b] The basis of this suggestion is that some common law systems do not require that the offer and the acceptance be in writing but instead require that a memorandum of the agreement be in writing. Accordingly, article 3 of ULF would not displace this requirement but would merely confirm the pre-existing rule that the offer and the acceptance need not be in writing (Unification of the Law Governing International Sales of Goods, editor John Honnold, Paris, Librairie Dalloz (1966), p. 372).

COMMENTARY

1. Proposed article 3A describes the means by which a contract can be modified or rescinded.

Modification and rescission of contracts, paragraph (1)

2. There is an important difference between the civil law and the common law in respect of the modification of existing contracts. In the civil law an agreement between the parties to modify the contract is effective if there is sufficient *cause* even if the modification relates to the obligations of only one of the parties. In the common law a modification of the obligations of only one of the parties is in principle not effective because consideration is lacking.

3. Article 3A (1) states that an agreement to modify or rescind the contract made by the parties in good faith is effective. The modifications envisaged by this provision are the technical modifications in specifications, delivery dates, or the like which frequently arise in the course of performance of commercial contracts. Even though such modifications of the contract may increase the costs of one party or decrease the value of the contract to the other, the parties may agree that there will be no change in the price. Article 3A (1) states that such agreements are effective thereby overcoming the common law rule that consideration is required.

4. However, article 3A (1) also states that the agreement must be "in good faith". These words are intended to give a tribunal the basis on which to refuse to enforce an agreement to modify the contract if that agreement was the result of improper pressures by one of the parties.

5. Although article 3 provides that the contract need not be in writing, it was noted in the commentary that the parties could reintroduce such a requirement. A similar problem is the extent to which a contract which specifically excludes modification or rescission unless in writing can be modified or rescinded orally.

6. In some legal systems a contract can be modified orally in spite of a provision to the contrary in the contract itself. It is possible that such a result would follow from article 3 of ULF which provides that a contract governed by this convention need not be evidenced by writing. However, the second sentence of article 3A (1) provides that a written contract which excludes any modification or rescission unless in writing cannot be otherwise modified or rescinded.

Waiver, paragraph (2)

7. Article 3A (2) recognizes that actions by one party on which the other party reasonably relies to his detriment might be such as to constitute a waiver of the requirement that any modification or rescission of the contract be in writing. In this respect article 3A (2) is similar to article 30 of the UNCITRAL Arbitration Rules which provides for a waiver of the requirement in article 1 (1) of those Rules that any modification of the rules be in writing.

8. Nevertheless, article 3A (2) goes on to provide that the party who has waived the requirement of a writing in respect of the modification of an unperformed portion of the contract can reinstate the original term in the contract to the extent that it would not cause the other party unreasonable inconvenience or unreasonable expense because of his reliance on the waiver.

ARTICLE 4

Text of ULF in annex I of the 1964 Convention

(1) The communication which one person addresses to one or more specific persons with the object of concluding a contract of sale shall not constitute an offer unless it is sufficiently definite to permit the conclusion of the contract by acceptance and indicates the intention of the offeror to be bound.

(2) This communication may be interpreted by reference to and supplemented by the preliminary negotiations, any practices which the parties have established between themselves, usage and any applicable legal rules for contracts of sale.

Text of ULF in annex II of the 1964 Convention

(1) The communication which one person addresses to one or more specific persons with the object of concluding a contract of sale shall not constitute an offer unless it is sufficiently definite to permit the conclusion of the contract by acceptance and indicates the intention of the offeror to be bound.

(2) This communication may be interpreted by reference to and supplemented by the preliminary negotiations, any practices which the parties have established between themselves, usage and the provisions of the Uniform Law on the International Sale of Goods.

Proposed alternative text

(1) A communication directed to one or more specific persons [or to the public] with the object of concluding a contract of sale constitutes an offer if it is sufficiently definite and indicates the intention of the offeror to be bound.

(2) This communication may be interpreted by reference to and supplemented by the preliminary negotiations, any practices which the parties have established between themselves, usage and any applicable legal rules for contracts of sale.

(3) An offer is sufficiently definite if it expressly or impliedly indicates at least the kind and quantity of the goods and that a price is to be paid.

(4) Subject to the contrary intention of the parties, an offer is sufficiently definite even though it does not state the price or expressly or impliedly make provision for the determination of the price of the goods. In such cases, the buyer must pay the price generally charged by the seller at the time of the conclusion of the contract. If no such price is ascertainable, the buyer must pay the price generally prevailing at the aforesaid time for such goods sold under comparable circumstances.

(5) An offer is sufficiently definite if it measures the quantity by the amount of goods available to the seller or by the requirements of the buyer. In such cases, the amount of goods available to the seller or the requirements of the buyer means the actual amount available or the actual amount required in good faith. However, the buyer is not entitled to demand nor compelled to accept a quantity unreasonably disproportionate to any stated estimate, or in the absence of a stated estimate, a quantity unreasonably disproportionate to any normal or otherwise comparable amount previously available or required.

COMMENTARY

1. The text of article 4 in annex II of the 1964 Convention is for use by those contracting States which are also contracting States to the 1964 Convention relating to ULIS. The text of article 4 in annex I of the 1964 Convention is for use by those contracting States which are not contracting States in regard to ULIS.

Communication by more than one person, paragraph (1)

2. Article 4 (1) specifies that the offer must be that of "one person". The drafting history does not make it clear why this requirement exists. However, it does not appear to have been a deliberate decision that two parties who jointly owned goods or two persons who wished to purchase goods together could not make such an offer. The proposed alternative text does not specify the number of persons who might jointly send the offer.

Communication to one or more specific persons, paragraph 1

3. Article 4 (1) provides that the offer must be addressed "to one or more specific persons". The words "or to the public" found in square brackets in the proposed alternative text would be an addition to the words used in ULF.

4. It was this requirement that the offer be addressed to specific persons which received the most attention in the 1964 Conference. In some countries a "public offer", i.e., a communication addressed to the general public, can be an offer in the legal sense if it meets the other criteria of an offer. Among the more frequent examples given are the display of goods in a shop window, with a price attached and the display of goods in an automatic vending machine. While these examples are of interest to demonstrate the theory of contract formation in various countries, they are of no importance in international trade.

5. However, the same problem arises in respect of advertisements in publications of general circulation such as newspapers and magazines, advertisements sent in the mail, and catalogues of goods available for sale. Such advertisements and communications are widely used as a means of stimulating sales of goods in international trade.

6. It would appear that a distinction should be made between those advertisements and catalogues which are sent in the mail directly to the addressee from those advertisements which are distributed to the general public. Those which are sent in the mail directly to the addressee are sent "to one or more specific persons", whereas those distributed to the general public are not. Nevertheless, in most cases an advertisement is not "sent with the object of concluding a contract" but as an invitation to deal, even if the advertisement is sent to a restricted list of addressees.

Sufficiently definite, paragraph 1

7. Article 4 (1) provides that in order to constitute an offer the communication must be "sufficiently definite to permit the conclusion of the contract by acceptance". Therefore, the offer must directly or indirectly contain all of the essential elements of the contract. However, neither article 4 nor any other provision in the ULF specifies what are those essential elements. The following paragraphs describe how the proposed alternative text of articles 4 (1), (3), (4) and (5) would set forth the essential elements of a contract of sale.

8. Article 4 (1) specifies only that the offer must be "sufficiently definite" rather than that it must be "sufficiently definite to permit the conclusion of the contract by acceptance". Paragraphs (3), (4) and (5) define some of the most important characteristics of an offer which is sufficiently definite.

9. Article 4 (3) states that the offer must contain at least three items to be sufficiently definite: (i) an indication of the kind of goods, (ii) an indication of the quantity of the goods, and (iii) an indication that a price is to be paid. If these three items are expressly or impliedly present in the communication, the communication is an offer and a contract will be concluded by the offeree's acceptance.

10. Article 4 (4) completes article 4 (3) in respect of the price. While article 4 (3) provides that the offer must indicate that a price is to be paid, article 4 (4) provides that the offer need not state the price or expressly or impliedly make provision for its determination. The provision goes on to repeat the language of article 36 of the draft CISG which provides the means of determining the price in such cases.

11. Article 4 (5) provides that offers in which the quantity is measured by the amount of goods available to the seller or the requirements of the buyer are sufficiently definite. Otherwise, the fact that the seller has some control over the amount he has available and the buyer has some control over his requirements has been held in some legal systems to mean that the quantity was at the discretion of that party and was therefore not sufficiently definite. It is desirable, however, that there be some limit on the permissible fluctuation of the amount the other party is obligated to buy or sell as the case may be. Therefore, if an estimate has been made of the amount the seller will have available or the requirements of the buyer or if there is prior experience with the amount the seller has had available or with the buyer's requirements, the other party is not obligated to accept, or to furnish, an amount unreasonably disproportionate to that estimate or to the prior experience.

Interpretation of the offer, paragraph 2

12. It should be noted that the version of article 4 (2) in annex II of the 1964 Convention may not be sufficient since there are many aspects of the law of contracts in general and sales in particular which are not covered by ULIS or by the draft CISG but which are relevant for the interpretation of the

offer. It may, therefore, be advisable to use only the version of article 4 (2) in annex I of the 1964 Convention.

ARTICLE 5

Text of ULF

(1) The offer shall not bind the offeror until it has been communicated to the offeree; it shall lapse if its withdrawal is communicated to the offeree before or at the same time as the offer.

(2) After an offer has been communicated to the offeree it can be revoked unless the revocation is not made in good faith or in conformity with fair dealing or unless the offer states a fixed time for acceptance or otherwise indicates that it is firm or irrevocable.

(3) An indication that the offer is firm or irrevocable may be express or implied from the circumstances, the preliminary negotiations, any practices which the parties have established between themselves or usage.

(4) A revocation of an offer shall only have effect if it has been communicated to the offeree before he has despatched his acceptance or has done any act treated as acceptance under paragraph 2 of article 6.

Proposed alternative text

(1) The offer can be accepted only after it has been communicated to the offeree. It cannot be accepted if its withdrawal is communicated to the offeree before or at the same time as the offer.

(2) After an offer has been communicated to the offeree it can be revoked if the revocation is communicated to the offeree before he has despatched his acceptance or has done any act treated as acceptance under article 6 (2). However, an offer cannot be revoked:

(*a*) During any time fixed in the offer for acceptance; or

(*b*) For a reasonable time if the offer otherwise indicates that it is firm or irrevocable; or

(*c*) For a reasonable time if it was reasonable for the offeree to rely upon the offer being held open and the offeree has altered his position to his detriment in reliance on the offer.

(3) An indication that the offer is firm or irrevocable may be express or may be implied from the circumstances, the preliminary negotiations, any practices which the parties have established between themselves or usage.

COMMENTARY

1. Article 5 states the time at which an offer becomes effective and the extent to which it is revocable. The proposed alternative text presents the same rules as does ULF but in a form which may make them more easily understood.

2. Article 5 (1) states the time after which the offer "binds" the offeror and the conditions under which its withdrawal causes the offer to "lapse". The proposed text of article 5 (1) states the time after which the offer can be accepted and the conditions under which its withdrawal makes it no longer subject to acceptance.

3. Article 5 (2) states a basic rule of the revocability of an offer while article 5 (4) states the events which terminate the offeror's power to revoke the offer. In the proposed text articles 5 (2) and 5 (4) of ULF are combined in article 5 (2).

4. Article 5 (2) provides that an offer which "states a fixed time for acceptance or otherwise indicates that it is firm or irrevocable" cannot be revoked. It would seem that what is meant is that the offer cannot be revoked during that fixed time or for a reasonable time, as the case may be. The proposed alternative text of article 5 (2) states the rule in this manner.

5. Although article 5 (2) (c) of the proposed alternative text is new, the rule it announces is thought to be that already in ULF. In article 5 (2) of ULF the offer cannot be revoked if the "revocation is not made in good faith or in conformity with fair dealing". The legislative history is not clear as to the factual situations which were thought to be subsumed in this provision.

6. It would appear, however, that the major, if not the only, factual situation which would generally be understood to fall within the language of article 5 (2) of ULF is that it was reasonable for the offeree to rely upon the offer being held open and the offeree has altered his position to his detriment in reliance on the offer. In such a case the offer would seem to be irrevocable for a reasonable period of time.

7. A major example of this rule would be where the offeree would have to engage in some extensive investigation to determine whether he should accept the offer. Even if the offer does not indicate that the offer is irrevocable, it should be irrevocable for the period of time necessary for the offeree to make his determination.

Effective date of the offer, paragraph 1

8. The offer can be accepted once it is "communicated" to the offeree. Article 12 (1) provides that the offer is communicated when it is delivered at the address of the person to whom the communication is directed.

9. The proposed alternative text of article 12 expands the definition of "communicated" by including within it, *inter alia*, an oral statement. Consequently, if an offeror sent his offer by mail but prior to its arrival he notified the offeree by telephone of the offer, the offer would be "communicated" by the telephone call.

Revocation, paragraphs 2 and 4

10. According to article 5 (2) an offer is in principle revocable. Article 5 (4) goes on to require that the revocation be communicated to the offeree before he has despatched his acceptance or has done any act treated as acceptance under article 6 (2). It should be noted that, contrary to the rule in most, if not all, legal systems, under these provisions the offeror loses the power to revoke an offer prior to the time the offer has been accepted since the offer can no longer be revoked once an acceptance has been sent even though it has not yet been received. However, under articles 6 (1) and 12 (1) an offer to conclude a contract by correspondence is accepted only when the acceptance has arrived. Presumably the contract is concluded at this time. This congruence of rules does not appear to have been the result of a deliberate decision. Instead, it appears to be the result of an incomplete integration of the two separate but related rules as to the period during which an offer can be revoked and the moment at which an offer has been accepted. Nevertheless, this incomplete integration appears to do little harm and may contribute to an effective compromise between the theory of despatch and the theory of reception.

11. The provision in article 5 (2) that an offer which states a fixed time for acceptance cannot be revoked during that fixed time should be read in conjunction with article 8 (1). The conjunction of the two provisions leads to the result that if an offer is stated to be open for a fixed period of time, such as 10 days, the offer cannot be revoked during that period. At the end of the period the offer can be revoked. Even if the offer is not revoked, according to article 8 (1) it could no longer be accepted, unless the conditions of article 9 are met.

ARTICLE 6

Text of ULF

(1) Acceptance of an offer consists of a declaration communicated by any means whatsoever to the offeror.

(2) Acceptance may also consist of the despatch of the goods or of the price of any other act which may be considered to be equivalent to the declaration referred to in paragraph 1 of this article either by virtue of the offer or as a result of practices which the parties have established between themselves or usage.

Proposed alternative text

(1) An offer is accepted by a declaration to that effect communicated by any means whatsoever to the offeror.

(2) The offer is also accepted if the offeree:

(*a*) Without delay ships either conforming or non-conforming goods unless the offeree notifies the offeror that the shipment of non-conforming goods is offered only for his accommodation; or

(*b*) Pays the price in accordance with the terms of the offer; or

(*c*) Commences any other act which indicates that the offer has been accepted; or

(*d*) Remains silent beyond the point of time when, because of the circumstances of the case, the practices the parties have established between themselves or usage, the offeree should have notified the offeror that he did not intend to accept.

(3) Where the offer is accepted by the shipment of the goods, payment of the price or the commencement of performance, an offeror who is not notified of the acceptance within a reasonable time may recover any damages caused thereby.

(4) (*a*) A contract is concluded at the moment the offer is accepted.

(*b*) A contract of sale may be found to be concluded even though the moment that it was concluded is undetermined.

COMMENTARY

Acceptance by declaration, paragraph 1

1. Article 6 (1) does not say what the declaration of acceptance must contain, but it is evident that it must accept the offer proposed by the offeror. In the past all legal systems have required that, at least in theory, the acceptance be equivalent to a simple "agreed". However, practical realities led the drafters of ULF to provide in article 7 (2) that in certain circumstances a reply to an offer which purports to be an acceptance is an acceptance even though it contains terms which are additional to or different from those in the offer. Such a rule has been carried forward to the current text. The extent to which this rule allows a deviation from the simple "agreed" is considered in the discussion of article 7.

Communication of the acceptance, despatch or receipt

2. Some legal systems consider the acceptance of an offer to have taken place on despatch of the notice of acceptance while other legal systems consider it to have taken place only on receipt by the offeror.

3. There are two main practical consequences which can arise from the differences in these two rules. If an acceptance is not effective until its receipt, the sender-offeree bears the risk of loss, delay or error in transmission whereas if the acceptance is effective upon despatch, the recipient-offeror bears the risk of loss, delay or error in transmission. Secondly, if the legal system in question provides that an offer is revocable, the offeror has a longer period during which to revoke the offer under the receipt theory than under the despatch theory.

4. It seems to be the case that those legal systems which follow the receipt theory of the effectiveness of an acceptance tend to uphold the irrevocability of the offer for a sufficient period of time for the offeree to accept whereas those legal systems which follow the despatch theory tend to recognize the revocability of the offer until its acceptance.[c]

5. ULF takes a middle position between the receipt and the despatch theories. According to article 6 (1) the offer is accepted once the declaration of acceptance has been "communicated" to the offeror. Since article 12 (1) provides that "to be communicated" means to be delivered at the address of the person to whom the communication is directed, ULF formally adopts the receipt theory.

6. However, most of the normal consequences which flow from the adoption of the receipt theory do not prevail.

7. First, according to article 9 an acceptance which arrives late is, or may be, deemed to have been communicated in due time. However, the sender-offeree still bears the risk of non-arrival of the acceptance and of any error in transmission. Secondly, even though the acceptance is not effective until receipt, the effect of article 5 (4) is that once the acceptance has been despatched the offer is irrevocable.

Means of communicating acceptance, paragraph 1

8. The provision in article 6 (1) that the declaration of acceptance may be communicated "by any means" to the offeror is intended to overcome the rule in some common law jurisdictions that the requirement that the acceptance be the same as the offer includes the requirement that the means of communicating the acceptance also be the same as the means by which the offer was communicated. The normal consequence of using a means of communication different from that used for the offer was that the acceptance was effective only on receipt rather than on despatch, thereby reversing the normal common law result. Under ULF it is not necessary to concern oneself with this consequence since the general rule is that the acceptance is effective only upon receipt. However, in some common law jurisdictions an acceptance communicated by a means other than that used for the offer would not be effective at all as an acceptance if the court is of the view that the offeror had impliedly prescribed the manner of acceptance. This result would be obviated by the words "by any means" and for this reason these words are useful, even though they may not be necessary in many legal systems.

9. It should be noted that article 2 authorizes the offeror, as an incidence of party autonomy, to require the offeree to use a particular means of communication for his acceptance. A particular means of acceptance may also be required as a result of "the practices which the parties have established between themselves or usage". In particular an offeror may require that the offer must be accepted in writing. Such a requirement by the offeror would prevail over the provisions of article 6 (1) that the offer can be accepted "by any means".

10. A further consequence of article 2 would be that the offeror could require that the offer be accepted by air mail and refuse to recognize an acceptance by telegram. The telegraphic acceptance would constitute a counter-offer which in turn would have to be accepted.

Acceptance by an act, paragraph 2

11. Although article 6 (1) recognizes that a declaration of acceptance normally takes the form of a verbal or written communication, it sometimes happens that the offeree does not reply to an offer to buy or sell goods but simply ships the goods, pays the price, or performs some other act which indicates that the offer has been accepted. Article 6 (2) provides that such an act is not a counter-offer but is an acceptance of the offer.

12. A problem which is unresolved in article 6 (2) is whether the shipment of non-conforming goods constitutes an acceptance of the offer. In article 5 (2) of the 1958 draft of ULF the despatch of the goods had to be "according to the conditions of the offer". Although the words of the 1958 draft suggest that there could be no deviation from the terms of the offer for the despatch of the goods to constitute an acceptance, including no deviation in respect of the quality of the goods shipped, it is less clear that this was the intention of the drafters.[d] However, if the despatch of the goods did not consti-

[c] Formation of Contracts: A study of the Common Core of Legal Systems (Schlesinger, ed., Oceana Publications, 1968), p. 115.

[d] At one stage of the discussion the representative of the Federal Republic of Germany pointed out that the words "to the conditions of the offer" do not mean delivery of goods without any defect but shipment made with intent to conform to the contract. (Diplomatic Conference on the Unification of Law Governing the International Sale of Goods, The Hague,

tute an acceptance, it was a counter-offer which would normally be accepted, if at all, by the buyer-offeror's acceptance of or payment for the goods.

13. At the 1964 Hague Conference the words "according to the conditions of the offer" were deleted. However, neither the records of the Conference nor the text as it was adopted makes it clear whether the deletion was intended to or had the effect of making the despatch of non-conforming goods an act of acceptance or whether there is still an implicit requirement that the goods be conforming.

14. The proposed text of article 6 (2) (*a*) provides that a shipment of non-conforming goods constitutes an acceptance of the offer. The terms of the contract which is concluded by the shipment of the non-conforming goods are those found in the offer. Therefore, the shipment of the non-conforming goods constitutes a breach of the contract as well as the act of formation and the buyer-offeror has available any remedy contained in the applicable law of sales. Under the draft CISG, those remedies include damages, reduction of the price, and, if the breach was fundamental, the right to the replacement of the non-conforming goods or the avoidance of the contract.

15. It should, of course, be noted that a seller-offeree who did not have available exactly what was ordered might deliberately ship non-conforming goods in the belief that the offeror would find them acceptable. This might happen in particular if the seller has discontinued manufacturing the specific catalogue item ordered and replaced it with a new catalogue item. In such a case, where the seller notifies the buyer-offeror that non-conforming goods are shipped only for his accommodation, the proposed article 6 (2) (*a*) provides that the shipment constitutes a counter-offer.

Acceptance by silence

16. Article 2 (2) states that "a term of the offer stipulating that silence shall amount to acceptance is invalid". However, that provision does not state that under no situations might the silence of the offeree constitute an acceptance. Proposed article 6 (2) (*d*) describes circumstances in which the silence of the offeree would constitute acceptance of the offer.

17. The general rule of proposed article 6 (2) (*d*) is that the offer is accepted if the offeree remains silent where, because of the circumstances of the case, the practices the parties have established between themselves or usage, it is reasonable that the offeree should notify the offeror if he does not intend to accept. For example, if the offeree were to reply to an offer that he no longer carried the specific item ordered but that he would ship the item carried as a replacement unless he heard to the contrary within 10 days, normal business practice would lead the original offeror to reply if he did not wish the replacement item. In such a case the silence of the original offeror would constitute an acceptance of the counter-offer.

Notification of the acceptance

18. ULF has no requirement that the offeree notify the offeror that he has shipped the goods, paid the price or performed any other act which constitutes an acceptance. As a result it is at least possible that the offeror might be bound for a considerable period of time to a contract when, from the silence of the offeree, he legitimately believed the offer to have lapsed.

19. As a practical matter, this situation is unlikely to happen often. If a buyer-offeree accepts by paying the price, the seller-offeror will most likely know of that event promptly. If a seller-offeree accepts the offer by shipping the goods by air, truck, or other means of rapid transport, the goods will often arrive within the period of time in which the buyer-offeror would have anticipated a reply. In such cases the act of acceptance naturally brings notice of the acceptance to the offeror.

20. The difficulty arises only if the act of acceptance is such that it does not by itself bring notice of the acceptance to the offeror in a reasonable period of time. Such acts might include the shipment of goods by sea or the commencement of manufacturing the goods. In such cases it would be normal business practice to send some documentation to the offeror indicating the actions taken or contemplated by the offeree. If the documentation arrived prior to the performance of the act in question, the documentation would serve as the declaration of acceptance. If it arrived after the performance of the act in question, it would serve as the notice of the acceptance.

21. Proposed article 6 (3) takes the position that failure to follow this normal business practice does not vitiate the effectiveness of the acceptance, but that the offeree must reimburse the offeror any damages caused by the failure to notify the offeror.

Conclusion of the contract

22. As ULF was finally adopted, it specified by the combination of articles 6 (1) and 12 (1) that acceptance by correspondence took place at the moment the declaration arrived at the address of the offeror. Presumably, the contract was concluded at that moment. However, such a result had to be drawn either as a natural consequence of the provisions of ULF or by the application of national law. It was not stated specifically in the text of ULF itself.

23. Proposed article 6 (4) (*a*) of the current text states that the contract is concluded at the moment the offer is accepted. This provision covers all forms of acceptances and not merely acceptances by correspondence.

24. It might be noted that the proposed article 6 (4) (*a*) is drafted, as are all texts in respect of offer and acceptance, on the assumption that there is a specific communication which can be recognized as an offer and a reply which can be recognized as an acceptance. In the vast majority of the cases this assumption is in accord with the facts. However, in a certain number of cases the parties may engage in an extensive correspondence in which various elements of the eventual contract are settled. If a controversy later develops, it may be difficult to isolate any single communication which can be said to be the offer and a reply which can be said to be the acceptance. Nevertheless, it may be clear that the parties have at some stage of their correspondence come to such agreement that a contract should be held to have been concluded even though the moment that it was concluded is undetermined.

25. Proposed article 6 (4) (*b*) formulates such a rule. It should be read in conjunction with article 4 on the definition of an offer and article 7 on acceptances which have additional or different terms.

Article 7

Text of ULF

(1) An acceptance containing additions, limitations or other modifications shall be a rejection of the offer and shall constitute a counter-offer.

(2) However, a reply to an offer which purports to be an acceptance but which contains additional or different terms which do not materially alter the terms of the offer shall constitute an acceptance unless the offeror promptly objects to the discrepancy; if he does not so object, the terms of the contract shall be the terms of the offer with the modifications contained in the acceptance.

2-25 April 1964, *Records and Documents of the Conference, Vol. I*, p. 221.) These words were deleted on the suggestion of the representative of the International Chamber of Commerce with the concurrence of the representative of the United States (vol. I, p. 221). However, the United States representative had earlier said that despatch of non-conforming goods was acceptance and enabled the injured party to resort to his remedies under ULIS (vol. I, p. 213). But it is doubtful whether all the other delegates who supported the deletion of this phrase shared the view of the United States representative that despatch of non-conforming goods constitutes acceptance (vol. I, pp. 213-214; vol. II, pp. 478-480).

Proposed alternative text

(1) A reply to an offer containing additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.

(2) (*a*) However, a reply to an offer which purports to be an acceptance but which contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance unless the offeror objects to the discrepancy without delay. If he does not so object, the terms of the contract are the terms of the offer with the modifications contained in the acceptance.

(*b*) If the offer and a reply which purports to be an acceptance are on printed forms and the non-printed terms of the reply do not materially alter the terms of the offer, the reply constitutes an acceptance of the offer even though the printed terms of the reply materially alter the printed terms of the offer unless the offeror objects to any discrepancy without delay. If he does not so object the terms of the contract are the non-printed terms of the offer with the modifications in the non-printed terms contained in the acceptance plus the printed terms on which both forms agree.

(3) If a confirmation of a prior contract of sale is sent within a reasonable time after the conclusion of the contract, any additional or different terms in the confirmation [which are not printed] become part of the contract unless they materially alter it, or notification of objection to them is given without delay after receipt of the confirmation. [Printed terms in the confirmation form become part of the contract if they are expressly or impliedly accepted by the other party.]

COMMENTARY

The general rule, paragraph 1

1. Article 7 (1) states the traditional rule that a purported acceptance which adds to, limits or otherwise modifies the offer to which it is directed is a rejection of the offer and constitutes a counter-offer.

2. This provision reflects traditional theory that contractual obligations arise out of expressions of mutual agreement. Accordingly, an acceptance must comply exactly with the offer. Should the purported acceptance not agree completely with the offer, there is no acceptance but the making of a counter-offer which requires acceptance by the other party for the formation of the contract.

3. Although the explanation for the rule expressed in article 7 (1) appears to lie in a widely held view of the nature of a contract, the rule also reflects the reality of the common factual situation in which the offeree is in general agreement with the terms of the offer but wishes to negotiate in regard to certain aspects of it. If the intent to engage in further negotiations is evident, it would be an unfortunate rule which would recognize a contract as being already in existence contrary to the will of the parties.

4. There are, however, other common factual situations in which the traditional rule, as expressed in article 7 (1), does not give desirable results. Article 7 (2) and proposed article 7 (3) create exceptions to article 7 (1) in regard to several of those situations.

Non-material alterations, paragraph 2

5. Article 7 (2) contains rules dealing with the situation where a reply to an offer is expressed and intended as an acceptance but contains new proposals or proposals which deviate in minor ways from the offer. For example, an offer stating that the offeror has 50 tractors for sale at a certain price is accepted by a telegram which adds "ship immediately" or "ship draft against bill of lading inspection allowed".

6. It should be noted that in most cases in which a reply purports to be an acceptance, any additional or different terms in the reply will not be material and, therefore, under article 7 (2) a contract will be concluded on the basis of the terms in the offer as modified by the terms in the acceptance. If the offeror objects to the terms in the acceptance, further negotiations will be necessary before a contract is concluded.

7. If the reply contains a material alteration, the reply would not constitute an acceptance but would constitute a counter-offer. Naturally, if the offeror then performed by shipping the goods, paying the price or otherwise commencing performance, the offeror would have accepted the counter-offer by virtue of article 6 (2). Therefore, a contract would be concluded and the terms of the contract would be those of the counter-offer.

8. It would be an unusual case in which an offeror who did not agree with the additional or different terms would not respond to the reply, whether or not the additional or different terms in the reply materially altered the terms in the offer. The offeror was the party who originally desired the conclusion of a contract and it would be expected that he would continue negotiations with the offeree looking towards the conclusion of a contract.

9. Therefore, the question as to whether a contract was concluded on the basis of the reply containing additional or different terms will almost always arise in a case in which the offeror decides, after the reply has been received but before performance has begun, that he no longer wishes to be bound by the contract. This will often be the result of a change in price for the goods. In this class of cases article 7 (2) says that the offeror is bound to the contract, subject only to the proviso that the additional or different terms in the reply did not materially alter the terms of the offer.

10. However, the rule in article 7 (2) does not give the same desirable result when both the offer and the acceptance are on printed forms. In such a case, the employees of both parties will rarely, if ever, read and compare the printed terms. All that is of importance to them are the terms which have been filled in on the forms. If those terms are identical, as they usually are, or contain only such additions as "ship immediately" or "ship draft against bill of lading inspection allowed", everyone will usually act as though a contract has been concluded even though there are gross discrepancies between the printed terms.

11. Proposed article 7 (2) (*b*) states that a contract has been concluded if the non-printed terms, i.e. the terms unique to the individual contract, are not materially different. If a contract has been concluded, the rule as to the terms of the contract distinguishes between the printed terms and the non-printed terms. As to the non-printed terms, the rule is the same as in article 7 (2), which is reproduced as proposed article 7 (2) (*a*), i.e. the terms of the contract are the terms of the offer with the modifications contained in the acceptance.

12. However, the only printed terms which would become terms of the contract are those on which both forms agree. If one form has terms not contained in the other form or if the two forms have inconsistent terms, those terms would not be part of the contract. In their place the governing rule will be that supplied by usage, any practices that the parties have established between themselves or by the applicable substantive law.

13. The formulation of proposed article 7 (2) is more detailed than that which is usually contained in a uniform law. However, it was considered that the subject-matter of proposed article 7 (2) required this degree of detail to achieve an appropriate result.

Confirmation of the conclusion of a contract

14. Typically, after the conclusion of an oral contract or after the conclusion of a contract by telegram or telex, one or both of the parties will send to the other a confirmation of the contract. The purpose of the confirmation is not only to produce a paper record of the transaction, but also to inform the other party of the terms of the contract as those terms were understood by the party sending the confirmation. Proposed article 7 (3) recognizes an obligation on the part of the party receiving the confirmation to verify whether those terms are consistent with his understanding of the contract and to object

if they are not. If he does not object, the terms in the confirmation become the terms of the contract unless it can be shown that they constitute a material alteration of the contract.

15. If the words in brackets were adopted, the rule as stated above would be modified so that it would accord, in essence, with the rule in proposed article 7 (2) (*b*). The terms of the contract would be the non-printed terms which did not materially alter the contract and to which the other party did not object plus the printed terms which were expressly accepted by the other party or which could in some manner be found to have been impliedly accepted by him. Such implied acceptance might be evidenced by showing a past practice of contracting on those terms or by showing actions in respect of this contract in a manner consistent with those terms. In any case, it would be the burden of the party who had sent the form to show that the other party had in some manner accepted the printed terms.

ARTICLE 8

Text of ULF

(1) A declaration of acceptance of an offer shall have effect only if it is communicated to the offeror within the time he has fixed or, if no such time is fixed, within a reasonable time, due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror, and usage. In the case of an oral offer, the acceptance shall be immediate, if the circumstances do not show that the offeree shall have time for reflection.

(2) If a time for acceptance is fixed by an offeror in a letter or in a telegram, it shall be presumed to begin to run from the day the letter was dated or the hour of the day the telegram was handed in for despatch.

(3) If an acceptance consists of an act referred to in paragraph 2 of article 6, the act shall have effect only if it is done within the period laid down in paragraph 1 of the present article.

Proposed alternative text

(1) Subject to article 9, an offer is accepted only if the declaration of acceptance is communicated to the offeror or any act referred to in article 6 (2) is performed within the time the offeror has fixed or, if no time is fixed, within a reasonable time, due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror. In the case of an oral offer, the acceptance must be immediate unless the circumstances show that the offeree is to have time for reflection.

(2) A period of time for acceptance fixed by an offeror in a telegram or a letter begins to run from the hour of the day the telegram is handed in for despatch or from the date shown on the letter or, if no such date is shown, from the date shown on the envelope. A period of time for acceptance fixed by an offeror in a telephone conversation, telex communication or other means of instantaneous communication, begins to run from the hour of the day that the offer is communicated to the offeree.

(3) If the last day of such period is an official holiday or a non-business day at the residence or place of business of the offeror, the period is extended until the first business day which follows. Official holidays or non-business days occurring during the running of the period of time are included in calculating the period.

COMMENTARY

Time for acceptance, paragraphs 1 and 3

1. Article 8 (1) states the traditional rule that an offer can be accepted only if the offeree acts within the time fixed by the offeror or, if no such time is fixed, within a reasonable time. However, since this rule is affected by article 9, a specific reference to article 9 has been added in the proposed article 8 (1).

2. The provision in article 8 (1), that in the case of an oral offer, the acceptance must be immediate, serves in practice as a rebuttable presumption as to the duration of a reasonable period of time. Article 8 (1) goes on to state that the presumption is rebutted if the circumstances show that the offeree is to have time for reflection.

3. Article 8 (1) specifies that in measuring what is a reasonable time, due account must be "taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror and usage". It should be noted that all of the text following the word "including" is by way of example of what is meant by the circumstances of the transaction. Other elements also may be taken into consideration, such as prior negotiations or the practices which the parties have established between themselves. In proposed article 8 (1) the words "and usage" have been deleted. It would also be possible to place the full stop after the word "transaction" or even after the words "reasonable time".

4. Article 8 (3) provides that the same rule as stated in article 8 (1) applies to an acceptance by an act referred to in article 6 (2). The proposed alternative text achieves the same result by incorporating article 8 (3) in the proposed article 8 (1).

Commencement of period of time to accept, paragraph 2

5. Article 8 (2) provides a mechanism for the calculation of the commencement of the period of time during which an offer can be accepted.

6. In the case of a letter, the time runs from "the day the letter was dated". It is not clear whether this means from the date shown on the letter or the date shown on the postmark. Proposed article 8 (2) provides that the time runs "from the date shown on the letter" unless no such date is shown, in which case it runs "from the date shown on the envelope". This order of preference is suggested for two reasons: first, the offeree may discard the envelope but he will have available the letter as the basis for calculating the end of the period during which the offer can be accepted and second, the offeror will have a copy of the letter with its date but will generally have no record of the date on the envelope. Therefore, if the date on the envelope controls, the offeror cannot know when the period terminates during which the offer can be accepted.

7. In the case of a telegram, the period begins to run from the hour of the day "the telegram is handed in for despatch". Such a rule works best if the telegram shows the time it is handed in for despatch or telephoned in for despatch in those countries where this is possible. If this is not a universal practice, a different time at which the period begins to run may be desirable.

End of the period for acceptance

8. Proposed article 8 (3) is based on article 2 (2) of the UNCITRAL Arbitration Rules.

ARTICLE 9

Text of ULF

(1) If the acceptance is late, the offeror may nevertheless consider it to have arrived in due time on condition that he promptly so informs the acceptor orally or by despatch of a notice.

(2) If however the acceptance is communicated late, it shall be considered to have been communicated in due time, if the letter or document which contains the acceptance shows that it has been sent in such circumstances that if its transmission had been normal it would have been communicated in due time; this provision shall not however apply if the offeror has promptly informed the acceptor orally or by despatch of a notice that he considers his offer as having lapsed.

Proposed alternative text

If a reply to an offer which purports to be an acceptance or any act referred to in article 6 (2) is communicated or performed late but the reply or the performance was made in good

faith, the offer is deemed to be accepted in due time unless without delay after the offeror learns of the acceptance he informs the offeree that the offer had lapsed.

COMMENTARY

1. Article 9 deals with acceptances that arrive after the expiration of the time for acceptance.

Power of offeror to consider acceptance as having arrived in due time, paragraph 1

2. If the acceptance is late, the offer has lapsed and no contract is formed by the arrival of the acceptance. However, it will often be the case that the offeror will still be interested in entering into a contract on the terms of his original offer. It appears that all legal systems are in agreement that this is possible; they differ only on the theory and to some degree on how this result may be achieved.

3. Some legal systems consider a late acceptance as a counter-offer. Considering a late acceptance as a counter-offer means that the original offeror must accept the counter-offer by one of the means by which any offer can be accepted and until he does so, no contract has been concluded.

4. Article 9 (1) takes a different approach. The late acceptance is considered to be a potentially effective acceptance. However, for it to become fully effective, the offeror must validate it by informing the offeree promptly that he considers it to have arrived in due time even though it was late.

5. It should be noted that both the system of article 9 (1) and a system which considers the late acceptance to be a counter-offer require an affirmative action by the original offeror for the contract to come into existence. If no communication is sent to the offeree, no contract exists. Except to the extent that article 9 (2) applies, this is true even if both the offeror and the offeree believe a contract exists.

Acceptances which are late because of a delay in transmission, paragraph 2

6. Since the acceptance is effective only when it has arrived, it would be expected that the risks of lost or delayed transmission would be on the acceptor. However, article 9 (2) provides that "if the letter or document which contains the acceptance shows that it has been sent in such circumstances that if its transmission had been normal it would have been communicated in due time", the acceptance which arrives late is considered to have arrived in due time. This shifts the risk of delayed transmission to the offeror but the risk of a lost transmission remains on the acceptor.

7. Article 9 (2) goes on to state that this provision does not apply if the offeror has promptly informed the offeror that he considers the offer as having lapsed.

8. It should be noted that the combination of the rules in articles 9 (1) and 9 (2) requires the offeror to notify the offeree whether or not he considers the late acceptance as having arrived in due time unless either (i) the offeror wishes the contract to come into effect and it is clear that the acceptance was sent in such circumstances that if its transmission had been normal it would have arrived in due time or (ii) the offeror does not wish the contract to come into effect and it is clear that the acceptance was not sent in such circumstances that if its transmission had been normal it would have arrived in due time. To the extent that the offeror is uncertain whether under normal circumstances the acceptance would have arrived in time by the means of communication chosen, he must send a notice of his decision in order to be sure of his rights.

9. The proposed article 9 adopts the principle of article 9 (2) and applies it to all late acceptances. In a commercial context it would normally be the case that the reply by the offeree which purports to be an acceptance was sent in good faith, whether or not a close analysis of the time it normally takes for a communication to go from the offeree to the offeror would show that the acceptance should have arrived in time. Therefore, the proposed article 9 would make it a general requirement for the offeror to inform the acceptor if he intends to treat a late acceptance as not having arrived in due time. However, if it is found that the offeree did not act in good faith, an offeror who failed to reply to the purported acceptance would not be held to have concluded a contract by reason of that failure.

ARTICLE 10

Text of ULF

An acceptance cannot be revoked except by a revocation which is communicated to the offeror before or at the same time as the acceptance.

Proposed alternative text

An acceptance cannot be revoked except by a declaration which is communicated to the offeror before or at the same time the declaration of acceptance is communicated to the offeror or, in the case of an acceptance by an act referred to in article (6) (2), before or at the same time as the offeror is informed of the acceptance.

COMMENTARY

1. In the case of an acceptance by correspondence, article 10 provides that the declaration of revocation of the acceptance must be communicated to the offeror before or at the same time as the acceptance is communicated to the offeror. However, article 10 gives no rule in case of an acceptance by means of an act referred to in article 6 (2).

2. The proposed alternative text provides that in the case of an acceptance by means of an act referred to in article 6 (2), the revocation of the acceptance must be communicated to the offeror before or at the same time as the offeror is informed of the act which constitutes acceptance. In this proposed text the emphasis is placed on the knowledge of the offeror at the time he learns of the revocation rather than on the question as to whether a contract has been concluded.

ARTICLE 11

Text of ULF

The formation of the contract is not affected by the death of one of the parties or by his becoming incapable of contracting before acceptance unless the contrary results from the intention of the parties, usage or the nature of the transaction.

Proposed alternative text 1

(1) (Same as article 11 of ULF.)

(2) If bankruptcy or similar proceedings are opened in respect of either party after the making of the offer, a revocable offer cannot be accepted. However, an irrevocable offer can be accepted during the period the offer is irrevocable.

Proposed alternative text 2

If either party dies or becomes physically or mentally incapable of contracting or if bankruptcy or similar proceedings are opened in respect of either party after the making of the offer, a revocable offer cannot be accepted. However, an irrevocable offer can be accepted during the period the offer is irrevocable.

COMMENTARY

1. Article 11 is limited to a statement that the formation of the contract is not affected by the death or physical or mental incapacity of a party.

2. Article 11 (2) of proposed alternative text 1 provides that a revocable offer cannot be accepted after the opening of bankruptcy or similar proceedings, but that such an event does not affect an irrevocable offer. This approach treats the irrevocable offer as a form of property or vested right, a position which appears to be generally adopted in most legal systems.

3. Proposed alternative text 2 provides a unitary rule for the death or physical or mental incapacity of a party and for

his bankruptcy. The rule is modelled on article 11 (2) of alternative 1. Therefore, the death or physical or mental incapacity of either party occurring after the making of a revocable offer as well as the opening of bankruptcy or similar proceedings would preclude the acceptance of the offer. However, none of these events would preclude the acceptance of an irrevocable offer.

Proposed Article 11A

Alternative 1

(1) A revocable offer may be assigned by the offeree unless within a reasonable time after the offeror learns of the assignment he notifies either the offeree or the assignee that he objects to it.

(2) An irrevocable offer may be assigned by the offeree to the extent that, if the contract was concluded, his rights and obligations under the contract could be assigned under the applicable law.

(3) The contract concluded by acceptance of the offer by the assignee arises only between the offeror and the assignee. However, the offeree is responsible for any failure to perform by the assignee if within a reasonable time after the offeror learns of the assignment he informs the offeree of his intention to hold him so responsible.

Alternative 2

(1) An offer may be assigned by the offeree unless within a reasonable time after the offeror learns of the assignment he notifies either the offeree or the assignee that he objects to it.

(2) The contract concluded by acceptance of the offer by the assignee arises only between the offeror and the assignee. However, the offeree is responsible for any failure to perform by the assignee if within a reasonable time after the offeror learns of the assignment he informs the offeree of his intention to hold him so responsible.

Alternative 3

(1) An offer may be assigned by either the offeror or the offeree unless within a reasonable time after the other party learns of the assignment that party notifies the assignor or the assignee that he objects to it.

(2) The contract concluded by acceptance of the offer arises only between the offeror and the assignee of the offeree or between the offeree and the assignee of the offeror, as the case may be. However, the assignor is responsible for any failure to perform by the assignee if within a reasonable time after the other party learns of the assignment he informs the assignor of his intention to hold him so responsible.

COMMENTARY

1. Classical theory prohibits the assignment of an offer, although many legal systems allow the assignment of irrevocable offers. To allow the assignment of an offer would permit the assignee to conclude a contract with the offeror even though the offer was not made to him. Nevertheless, in practice it is occasionally important that an assignment of an offer be allowed. One such case arises when the offeree is reorganized and a successor company accepts the offer. It is normally to the advantage of both parties that the contract is concluded by the acceptance of the offer by the assignee. The extent to which an offer can be assigned should also be considered in the light of the extent to which either party could assign his rights or delegate his duties under the contract once it was concluded.

2. Alternatives 1 and 2 provide for assignment of the offer only by the offeree. Alternative 3 allows the offeror also to assign, a provision which would be primarily applicable to an offeror who has been reorganized after the offer was made.

3. Alternative 1 distinguishes between revocable and irrevocable offers. A revocable offer can be assigned by the offeree unless the offeror objects. An irrevocable offer can be assigned by the offeree without the consent of the offeror to the extent that, if the contract was concluded, the offeree's rights and obligations could be assigned under the applicable law. Although it is undesirable to refer to national law in order to determine the extent of the right to assign the offer, some limitation must be introduced. The limitation proposed has the merit of already existing. If the Working Group accepts the principle of alternative 1, it might consider whether the limitation of the right to assign an irrevocable offer should be specifically established by article 11A (2) rather than leaving the matter to be determined by national law.

4. Alternative 2 makes no distinction between revocable and irrevocable offers. The offeree may assign the offer subject to the offeror's right to object.

5. Alternative 3 follows the pattern of alternative 2 except that the offer can be assigned by either the offeror or the offeree, subject to the other party's right to object. Of course, it would be possible to model a fourth alternative on alternative 1.

6. The last paragraph in all three alternatives specifies the parties to the contract which results if the offer which has been assigned is accepted. In all three alternatives the assignor, whether he be offeror or offeree, is not a party to the contract. However, he may be held responsible for the failure of the assignee to perform if the other party takes the necessary steps to assure himself of this guarantee.

Article 12

Text of ULF

1. For the purposes of the present Law, the expression "to be communicated" means to be delivered at the address of the person to whom the communication is directed.

2. Communications provided for by the present Law shall be made by the means usual in the circumstances.

Proposed alternative text

For the purposes of this Convention an offer, declaration of acceptance or any other notice is "communicated" when it is told orally to the party concerned or when it is physically delivered to the addressee or when it is [physically, mechanically or electronically] delivered to his place of business, mailing address or habitual residence.

COMMENTARY

1. Article 12 (1) sets forth the principle that communications are effective on receipt.

2. The proposed alternative text expands on article 12 (1) of ULF in that provision is made for oral communications and for the physical delivery of a communication to the addressee. In addition, following the example of the UNCITRAL Arbitration Rules, the various permissible addresses of the addressee to which the communication may be sent are set forth.

3. The words in brackets in article 12 seek to make provision not only for traditional postal and telegraphic deliveries but also for modern means of communication such as telex machines or computer terminals. It should be noted that these words would be additions to the text as it is set out in the UNCITRAL Arbitration Rules.

4. Article 12 (2) of ULF, also found in almost identical terms in article 10 (1) of the draft CISG, which provides that "communications provided for by the present law shall be made by the means usual in the circumstances" was not included in the proposed article 12 because it was in conflict with article 6 (1) that an acceptance may be communicated "by any means".

Article 13

Text of ULF

1. Usage means any practice or method of dealing, which reasonable persons in the same situation as the parties usually consider to be applicable to the formation of their contract.

2. Where expressions, provisions or forms of contract commonly used in commercial practice are employed, they shall be interpreted according to the meaning usually given to them in the trade concerned.

Proposed alternative text

Usage means any practice or method of dealing of which the parties knew or had reason to know and which in international trade is widely known to and regularly observed by parties to contracts of the type involved in the particular trade concerned.

COMMENTARY

The proposed alternative text has been drafted to conform as closely as possible to the text of article 8 of the draft CISG. In particular, this has meant the deletion of article 13 (2) of ULF.

APPENDIX II

UNIDROIT draft of a law for the unification of certain rules relating to validity of contracts of international sale of goods:[a] critical analysis

ARTICLE 1

(1) The present law applies to contracts of sale of goods entered into by parties whose places of business are in the territories of different States, in each of the following cases:

(*a*) Where the contract involves the sale of goods which are at the time of the conclusion of the contract in the course of carriage or will be carried from the territory of one State to the territory of another;

(*b*) Where the acts constituting the offer and the acceptance have been defected in the territories of different States;

(*c*) Where delivery of the goods is to be made in the territory of a State other than that within whose territory the acts constituting the offer and the acceptance have been effected.

(2) Where a party to the contract does not have a place of business, reference shall be made to his habitual residence.

(3) The application of the present law shall not depend on the nationality of the parties.

(4) In the case of contracts by correspondence, offer and acceptance shall be considered to have been effected in the territory of the same State only if the letters, telegrams or other documentary communications which contain them have been sent and received in the territory of that State.

(5) For the purpose of determining whether the parties have their places of business or habitual residences in "different States", any two or more States shall not be considered to be "different States" if a valid declaration to that effect made under Article ... of the Convention dated ..... relating to a Law for the unification of certain rules relating to validity of contracts of international sale of goods is in force in respect of them.

(6) The present Law shall not apply to contracts of sale:

(*a*) Of stocks, shares, investment securities, negotiable instruments or money;

(*b*) Of any ship, vessel or aircraft, which is or will be subject to registration;

(*c*) Of electricity;

(*d*) By authority of law or on execution or distress.

(7) Contracts for the supply of goods to be manufactured or produced shall be considered to be sales within the meaning of the present law, unless the party who orders the goods undertakes to supply an essential and substantial part of the materials necessary for such manufacture of production.

(8) The present law shall apply regardless of the commercial or civil character of the parties or of the contracts to be concluded.

(9) Rules of private international law shall be excluded for the purpose of the application of the present law, subject to any provision to the contrary in the said law.

COMMENTARY

1. This article states the general rules for determining whether the draft law is applicable to a contract of sale of goods.

2. If the Working Group decides to prepare a draft convention on validity of contracts for the international sale of goods, presumably article 1 would be redrafted to conform to the sphere of application of the Convention on the International Sale of Goods (CISG).

ARTICLE 2

(1) The present law shall not apply to the extent that the parties have agreed, expressly or impliedly, that it is inapplicable.

(2) However, in the case of fraud and in the case of threat, the present law may not be excluded or departed from to the detriment of the aggrieved party.

COMMENTARY

1. Article 2 (1) reiterates the principle of party autonomy in respect of the international sale of goods which is also found in article 2 (1) of the Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF), article 3 of the Uniform Law on the International Sale of Goods (ULIS) and article 5 of the draft CISG. However, article 2 (2) provides that the law cannot be excluded or departed from to the detriment of the aggrieved party in the case of fraud or in the case of threat (duress). There is no bar to the inclusion of higher standards in respect of these matters in the contract.

2. It is submitted that article 2 gives a broader role to the principle of party autonomy than is warranted. Most of the rules in respect of validity of contracts are rules from which the parties should not be able to derogate. This applies in particular to such provisions in the LUV as the power of the court to determine the "actual common intent" of the parties in the case of a simulated contract,[b] the determination of whether a usage is valid,[c] or the criteria for the determination whether a contract can be avoided for mistake.[d]

3. Certain rules in respect of the validity of contracts should be subject to the will of the parties. In such a case the substantive rule should reflect the extent to which the parties may affect the operation of the rule. The LUV already adopts that principle of drafting in such provisions as article 6 (*b*) which provides that a party may avoid a contract for mistake only if, *inter alia*, "the mistake does not relate to a matter in regard to which, in all the relevant circumstances, the risk of mistake was expressly or impliedly assumed by the party claiming avoidance".

ARTICLE 3

(1) Statements by and acts of the parties shall be interpreted according to their actual common intent, where such an intent can be established.

(2) If the actual common intent of the parties cannot be established, statements by and acts of the parties shall be in-

[a] The draft Law is hereafter referred to as LUV in the commentaries. The English and French language versions are the texts approved by the Governing Council of UNIDROIT on 31 May 1972 and set out in the following bilingual publication of UNIDROIT: ETUDE XVI/B, Doc.22, U.D.P. 1972. The Russian and Spanish versions have been prepared by the United Nations Secretariat.

[b] Article 3 (1).

[c] Article 4 (3).

[d] Articles 6 to 9.

terpreted according to the intent of one of the parties, where such an intent can be established and the other knew or ought to have known what that intent was.

(3) If neither of the preceding paragraphs is applicable, the statements by and the acts of the parties shall be interpreted according to the intent that reasonable persons would have had in the same situation as the parties.

COMMENTARY

1. Article 3 sets out rules for the interpretation of the statements and acts of the parties to a contract of sale of goods to which the uniform law applies. The rules in article 3 are supplemented and expanded by those contained in article 4.

2. The report of the Max-Planck Institut für ausländisches und internationales Privatrecht (hereafter referred to as the Max-Planck report) states that the rules of interpretation are necessary (i) to establish whether there is a contract in order to ascertain whether it may be avoided for fraud, threat or mistake, (ii) to establish which facts entitle a party to avoid a contract and (iii) to ascertain the importance of the mistake.[e]

3. Although the report goes on to state that "the import of the rules on interpretation is limited to the present draft",[f] it would appear that the text of neither article 3 nor article 4 so limits their application. Articles 3 and 4 contain rules of interpretation to be used for all purposes for which the contract must be interpreted. Moreover, it would be inappropriate to have more than one set of rules of interpretation to be applied to a single contract. But this may occur if article 3 is retained as its rules differ from the more limited rules of interpretation contained in the draft CISG.

4. The rules of interpretation set forth in article 3 are, in general, appropriate so far as they go. However, it should be noted that, according to article 3 (3), unless there can be determined the actual common intent of the parties or the actual intent of one party which the other knew or of which he ought to have known, the statements and acts of the parties are to be interpreted "according to the intent that reasonable persons would have had in the same situation". Since in most difficult questions of interpretation there will be neither a common intention of the parties nor an intention of one party of which the other party knew or ought to have known, it follows that the test in article 3 (3) will be the primary tool of interpretation used by a tribunal to resolve such questions.

5. It may be suggested that a major difficulty with article 3 (3) is that the two parties to the contract are in different situations and consequently two "reasonable persons", one in the situation of the buyer and the other in the situation of the seller, might well have the same disagreement over the interpretation of the contract as the parties themselves. While this is also true of two parties within a given country, the problem is accentuated in international transactions. Different ways of doing business, different legal and economic systems and even the possibility of two different texts of the contract (if the contract is in two languages and the translation is inadequate) may render any objective interpretation of the contract impossible. In such a situation, article 3 gives no aid to a tribunal as to how to resolve the difficulty.

ARTICLE 4

(1) In applying the preceding Article due consideration shall be given to all relevant circumstances, including any negotiations between the parties, any practices which they have established between themselves, any usages which reasonable persons in the same situation as the parties usually consider to be applicable, the meaning usually given in any trade concerned to any expressions, provisions or contractual forms which are commonly used, and any conduct of the parties subsequent to the conclusion of the contract.

(2) Such circumstances shall be considered, even though they have not been embodied in writing or in any other special form; in particular, they may be proved by witnesses.

(3) The validity of any usage shall be governed by the applicable law.

COMMENTARY

1. Article 4 (1) is similar to article 4 (2) of ULF. If a text on validity of contracts were to be adopted, it should be redrafted to conform to that adopted for the formation of contracts.

2. The Max-Planck report notes that a member of the committee that prepared the draft uniform law on validity considered that it might cause problems in some common law jurisdictions to provide that a contract could be interpreted by a tribunal in the light of "any conduct of the parties subsequent to the conclusion of the contract". However, as that report notes, the rule in the uniform law, if adopted by a given country, would supersede any contrary rule in municipal law.[g] Furthermore, at least one common law country has adopted a rule by statute that the conduct of the parties in performing their obligations under the contract is relevant in determining the meaning of the contract.[h]

3. Article 4 (2) would seem to be a self-evident provision since several of the sources mentioned in article 4 (1) by their very nature would often not be in writing.

4. Article 4 (3) is a reiteration of what the law would be without the provision. The only other alternative would be to set forth the criteria for the validity of a usage.

5. It should be noted that under article 2 the parties appear to have the power to determine their own tests for the validity of a usage.

ARTICLE 5

There is no contract if, under the provisions of the preceding articles, an agreement between the parties cannot be established.

COMMENTARY

1. Article 5 completes the set of three articles on interpretation by providing that no contract exists if no agreement between the parties can be established from the statements and acts of the parties as properly interpreted according to articles 3 and 4. It should be noted that the consequence which follows from the finding of a mistake under articles 6 to 9, fraud under article 10 or improper threat under article 11 is the right of the mistaken, defrauded or threatened party to avoid the contract.

2. If a provision such as that in article 5 is thought to be desirable, it may perhaps better be placed with the provisions on formation of the contract rather than with the provisions on validity of contracts.

ARTICLE 6

A party may only avoid a contract for mistake if the following conditions are fulfilled at the time of the conclusion of the contract:

(*a*) The mistake is, in accordance with the above principles of interpretation, of such importance that the contract would not have been concluded on the same terms if the truth had been known; and

(*b*) The mistake does not relate to a matter in regard to which, in all the relevant circumstances, the risk of mistake

[e] ETUDE XVI/B, Doc.22, U.D.P. 1972, pp. 21 and 23. All page references given below in foot-notes pertain to the English language version of the Max-Planck report reproduced in that publication.

[f] P. 23.

[g] P. 25.

[h] Sect. 2-208 (1), Uniform Commercial Code, United States.

was expressly or impliedly assumed by the party claiming avoidance; and

(c) The other party has made the same mistake, or has caused the mistake, or knew or ought to have known of the mistake and it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error.

COMMENTARY

1. Article 6 is the first of four articles dealing with mistake and is the basic article in which the major policy decisions taken by UNIDROIT in respect of mistake are to be found.

2. Article 6 presents a number of problems, some of which may be inherent in a text on the unification of the law on mistake.

3. The first test that a mistake must satisfy to enable avoidance of the contract is that it be of such importance that the contract would not have been concluded on the same terms if the truth had been known. A problem with this formulation is that whenever there is a mistake, at least some of the terms of the contract would probably have been altered in at least a minor respect if the party that had made the mistake had been aware of that mistake. Such a result is clearly not intended.[1]

4. A similar problem was faced by the Working Group in defining the concept of "fundamental breach" in the draft CISG. In article 10 of ULIS a breach is regarded as fundamental "wherever the party in breach, knew, or ought to have known at the time of the conclusion of the contract, that a reasonable person in the same situation as the other party would not have entered into the contract if he had foreseen the breach and its effects". This definition has been changed in article 9 of the draft CISG so that a breach is fundamental "if it results in substantial detriment to the other party and the party in breach foresaw or had reason to foresee such a result".

5. Article 6 (b) requires a determination whether the party claiming avoidance of the contract for mistake had expressly or impliedly assumed the risk of the mistake. While it is certainly correct that a party who has assumed the risk that a mistake may exist should not be able to avoid the contract for that mistake, the text gives no assistance in determining under what circumstances it should be held that a party assumed the risk of mistake.

6. Article 6 (c) sets forth a further requirement for the avoidance of the contract. The party not claiming avoidance must either (i) have made the same mistake, or (ii) have caused the mistake, or (iii) have known or ought to have known of the mistake and not have told the party claiming avoidance even though it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error.

7. It is doubtful if a uniform body of interpretation could be developed as to the circumstances under which one party may be held to have caused the other party to be mistaken. It is also doubtful whether a uniform body of interpretation could be developed as to whether the other party should have known of the mistake or whether reasonable commercial standards of fair dealing would require him to notify the mistaken party of the error.

8. Articles 6 and 14 (3) provide that the remedy available to a mistaken party is to avoid the contract and, to the extent permitted by the applicable law, to claim damages. In addition, article 15 recognizes that if the co-contractant of the mistaken party declares himself willing to perform the contract as it was understood by the mistaken party, the contract shall be considered to have been concluded as the latter understood it. However, if there is no acquiescence on the part of the other party, no possibility of reforming the contract is possible.

9. It may be observed that article 14 (4) provides that if the mistake was at least in part the fault of the mistaken party, the other party may obtain damages from the mistaken party who avoided the contract.

[1] It should also be noted that article 10 allows a party to avoid the contract for fraud only if the mistake caused by the fraud was sufficiently important as to induce him to conclude the contract.

ARTICLE 7

(1) A mistake of law shall be treated in the same way as a mistake of fact.

(2) A mistake in the expression or transmission of a statement of intention shall be considered as the mistake of him from whom the statement emanated.

COMMENTARY

1. Although many legal systems do not consider a mistake of law to have the same legal effect as a mistake of fact, it is reasonable to do so in respect of a contract of international sale of goods. The legal rules governing such contracts are voluminous and complex and at least in part will be rules of a foreign legal system. It would be unreasonable to assume knowledge by the parties of the existence and effect of all such laws.

2. The rule in article 7 (2) that a mistake in the expression or transmission of a statement of intention shall be considered as the mistake of him from whom the statement emanated appears to place the consequences of the mistake on the party who chose the means of communication. However, the result is the opposite since it is only the party who is mistaken, i.e., the party who sends the message, who can avoid the contract under article 6 (2). The practical consequence is that if an offeror-seller offered to sell goods at 8 per unit but the message was transmitted to the offeree-buyer as 7 per unit and he accepted at that price, the offeror-seller could avoid the contract. However, if the message was transmitted at 9 per unit and the offeree-seller accepted at that price, the offeror-seller would have no reason to avoid the contract and the offeree-buyer could not do so.

3. There is a difficulty in determining on what occasions the receiver of a message may have impliedly assumed the risk of mistake as provided in article 6 (b). The Max-Planck report suggests that this will occur in "some cases" without specifying what those cases might be.[1]

ARTICLE 8

A mistake shall not be taken into consideration when it relates to a fact arising after the contract has been concluded.

COMMENTARY

1. Article 8 serves as a rule delimiting the scope of application of the LUV in relation to mistake. The LUV does not apply to a mistake in respect of an event which occurs after the conclusion of the contract. The LUV does apply to a mistake in respect of an event which occurs before the conclusion of the contract, unless the mistake is one which falls under article 9 or 16.

2. The effect of articles 9 and 16 is that if the mistake goes to the non-conformity of the goods or the rights of third parties in the goods or if the mistake relates to the impossibility of performing the assumed contractual obligation, LUV does not permit avoidance of the contract. Presumably such cases would be governed by the substantive law of sales.

ARTICLE 9

The buyer shall not be entitled to avoid the contract on the ground of mistake if the circumstances on which he relies afford him a remedy based on the non-conformity of the goods with the contract or on the existence of rights of third parties in the goods.

[1] P. 35.

COMMENTARY

1. Article 9 does not permit avoidance of the contract for mistake when the buyer has a remedy based on the non-conformity of the goods or on the existence of rights of third parties. The Max-Planck report indicates that article 9 also prohibits avoidance of the contract in "those cases in which the buyer might have relied on a remedy under [the draft CISG] if, in the circumstances, those remedies had not been barred (for example, because the lack of conformity is immaterial or the buyer has not given prompt notice . . .)".[k] It would seem that this interpretation of article 9 leads to the conclusion that the LUV is never applicable to a mistake as to the quality of the goods or as to the rights of third parties. In all such cases the substantive law of sales would have to apply.

2. The scope of application of article 9 would have to be carefully defined if article 7 (2) of the draft CISG, which was left in square brackets by the Working Group, is retained.[l]

Article 10

(1) A party who was induced to conclude a contract by a mistake which was intentionally caused by the other party may avoid the contract for fraud. The same shall apply where fraud is imputable to a third party for whom the other party is responsible.

(2) Where fraud is imputable to a third party for whose acts the other contracting party is not responsible, the contract may be avoided for fraud if the other contracting party knew or ought to have known of the fraud.

COMMENTARY

1. Article 10 deals with avoidance of the contract for fraud.

2. According to the Max-Planck report, in contrast to a "simple" mistake under article 6, the mistake which was fraudulently caused need not have been "essential" to authorize the defrauded party to avoid the contract.[m] However, it may be noted that in article 6 (*a*) the "simple" mistake need only be "of such importance that the contract would not have been concluded on the same terms if the truth had been known" whereas under article 10 the fraudulently caused mistake must have induced the other party to conclude the contract. It is evident that the mistake must be more serious to induce the conclusion of the contract than to cause it to be concluded on different terms than it would have been if the truth had been known.

3. It is intended that "mere puff in advertising or negotiations in itself does not suffice" to constitute fraud.[n] The text of article 10 does not furnish the basis on which to distinguish between those advertising claims which are "mere puff" and those which constitute fraud.

Article 11

A party may avoid the contract when he has been led to conclude the contract by an unjustifiable, imminent and serious threat.

COMMENTARY

1. Article 11 does not attempt to describe what kind of threats would be "unjustifiable". As stated in the Max-Planck report, "in deciding when a threat is justifiable and when it is not, due consideration must be given to the entire contractual context and to the purposes that the person uttering the threat thereby sought to achieve".[o]

2. Nevertheless, it would seem necessary to determine what forms and what degree of pressure are acceptable in order to determine what kinds of threats are unjustifiable. It can be expected that there would be a wide range of views on the forms and degree of pressure which are acceptable as a means of inducing the conclusion of a contract.

3. In all legal systems a threat of physical harm is unjustifiable, and this is, indeed, the classical example of duress. There is probably also agreement that it is justifiable to threaten civil action to enforce an obligation which the claimant believes in good faith to be due. However, there would probably be no agreement at what point, if any, the threat of civil action or of attachment of goods or of similar proceedings in connexion with a civil action would become unjustified harassment. Other typical threats which might be viewed as justifiable in some legal systems, but as unjustifiable in others, would include a refusal by a bailee to surrender goods on the owner's demand unless paid a sum which is not due but which the bailee believes in good faith to be due, and the threat to start a criminal prosecution for the purpose of collecting a private claim.

4. Although the examples given may be peripheral problems in the context of international trade, the question as to whether a contract was concluded by reason of economic duress has a potentially greater significance.[p] Many legal systems have rejected the concept of economic duress. Nevertheless, many of those same legal systems have reached results similar to those which would result from an acceptance of a concept of economic duress. However, such concepts are closely linked to the particular notions of public policy that prevail in each individual legal system. It is thus difficult to anticipate agreement on the nature of the economic threats that would be considered to be "unjustifiable" under article 11.

Article 12

(1) Avoidance of a contract must be by express notice to the other party.

(2) In the case of mistake or fraud, the notice must be given promptly, with due regard to the circumstances, after the party relying on it knew of it.

(3) In the case of threat, the notice must be given promptly, with due regard to the circumstances, after the threat has ceased.

COMMENTARY

1. The requirement that a contract can be avoided only by express notice to the other party is in accord with article 10 (2) of the draft CISG. The requirement that the notice be given within a restricted time-limit is in accord with articles 30 (2) and 45 (2) of the draft CISG, but the exact wording of the time-limit is somewhat different.

2. It might be remarked that a remedy system which seeks to provide relief in the case of fraud should not require as an absolute prerequisite to that relief that avoidance must be by express notice which is received by the other party for, on occasion, a fraudulent party may be difficult to locate.

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[k] Pp. 37-39.

[l] Article 7 (2) provides that CISG does not govern the rights and obligations which might arise between buyer and seller because of the existence in any person of rights or claims which relate to intellectual or industrial property or the like.

[m] P. 39.

[n] *Ibid.*

[o] P. 41.

[p] It is doubtful whether the drafters of article 11 intended that economic duress be included. The Max-Planck report points out that a provision was discussed by the UNIDROIT committee which prepared the draft LUV which would have permitted "the avoidance of a contract if there is an obvious inequality between the contractual performances required of the parties and if one party has been led to enter into the contract by an abusive exploitation of his personal or economic situation" (pp. 17-19). The majority of the committee rejected this rule because of the uncertainty it would introduce into international trade since uniformity in its application would be unlikely.

ARTICLE 13

(1) In case of mistake, any notice of avoidance shall only be effective if it reaches the other party promptly.

(2) In any event, the notice shall only be effective if it reaches the other party within two years after the conclusion of the contract in the case of mistake or within five years after the conclusion of the contract in the other cases.

COMMENTARY

1. Article 13 adopts a reception theory in respect of notices in contrast with article 10 (3) of the draft CISG which gives effect to a notice which has been sent by appropriate means within the required time even if that notice fails to arrive or fails to arrive within the required time or even if the contents of the notice have been inaccurately transmitted.

2. The point of time at which the period of five years commences during which, at a maximum, the notice of avoidance must be received by the other party in case of fraud differs from the point of time at which the four year period of limitation begins under the Convention on the Limitation Period in the International Sale of Goods. Article 10 (3) of that Convention recognizes the special character of fraud by providing that a claim based on fraud accrues on the date on which the fraud was or reasonably could have been discovered. However, article 13 (2) of LUV provides that a notice of avoidance of the contract for fraud must be given within five years from the conclusion of the contract.

ARTICLE 14

(1) Notice of avoidance shall take effect retroactively, subject to any rights of third parties.

(2) The parties may recover whatever they have supplied or paid in accordance with the provisions of the applicable law.

(3) Where a party avoids a contract for mistake, fraud or threat, he may claim damages according to the applicable law.

(4) If the mistake was at least in part the fault of the mistaken party, the other party may obtain damages from the party who has avoided the contract. In determining damages, the court shall give due consideration to all relevant circumstances, including the conduct of each party leading to the mistake.

COMMENTARY

1. Article 14 deals with the effects of avoidance. It reaches results which are similar to, but slightly different from, those reached under articles 51 to 54 of the draft CISG.

2. Article 14 (1) provides that the avoidance of the contract is retroactive, i.e. that the contract is regarded as never having existed. The natural consequences of this rule would seem to be that there should be mutual restitution of any goods or money handed over to the other party. Article 51 (2) of the draft CISG specifically provides such a requirement in respect of an avoidance of a contract under that text. However, article 14 (2) of LUV provides for restitution only "in accordance with the provisions of the applicable law".

3. Article 14 (1) notes that even though a contract which is avoided is treated as though it never existed, the rights of third parties may not be affected. Although there is no provision exactly comparable in the draft CISG, article 52 (2) (*c*) of the draft CISG recognizes that a buyer may not be able to make restitution of goods delivered to him because they have been sold in the normal course of business, thereby recognizing the right of the third-party purchaser to retain them.

4. The Max-Planck report points out that avoidance nullifies the entire contract. However, the report also takes the view that in the case of a complex contract having several objects or parties, only some of which are effected by the mistake, fraud or threat, the contract "may be considered severable so that avoidance of one contract need not affect the other".[q] Although such a result is reasonable and can be attained in similar circumstances under the draft CISG,[r] it does not follow from the text of the LUV.

5. Article 14 (3) recognizes that the grounds which justify the avoidance of a contract for mistake, fraud or threat may also justify a claim for damages. However, article 14 (3) does not decide either the circumstances under which damages may be claimed or the amount of such damages but refers both matters to the applicable law.

6. Since LUV allows a party to avoid the contract for mistake even though the mistake was at least in part his own fault, article 14 (4) provides that in such a circumstance the party who has avoided the contract may be obligated to pay damages to the other party. The amount of the damages is to be determined by considering all the circumstances, "including the conduct of each party leading to the mistake". Therefore, the amount of damages is to be determined not only by the amount of loss suffered, but by the comparative fault of the parties.

ARTICLE 15

(1) If the co-contractant of the mistaken party declares himself willing to perform the contract as it was understood by the mistaken party, the contract shall be considered to have been concluded as the latter understood it. He must make such a declaration promptly after having been informed of the manner in which the mistaken party had understood the contract.

(2) If such a declaration is made, the mistaken party shall thereupon lose his right to avoid the contract and any other remedy. Any declaration already made by him with a view to avoiding the contract on the ground of mistake shall be ineffective.

COMMENTARY

1. Article 15 applies only in cases of mistake and not to cases of fraud or threat. It allows the co-contractant of the mistaken party to preserve the contract by agreeing to perform the contract as it was understood by the mistaken party. This not only allows a reformation of the contract but also precludes the mistaken party from using the mistake as a spurious means of avoiding the contract.

2. It may be noted that in fact the mistaken party has a similar option, i.e. he can agree to perform the contract as it was concluded and not exercise his right to avoid the contract. However, the mistaken party has no right to have the contract reformed to that which it would have been had there been no mistake.

3. Article 15 (2) provides that if a declaration is made under article 15 (1), the mistaken party not only loses his right to avoid the contract but also loses any other remedy he may have. In addition, any declaration of avoidance by the mistaken party is ineffective.

4. This drastic provision not only precludes avoidance of the contract but also takes away from the mistaken party any right to damages that he may have had under national law. It should be noted that this result is achieved even in those cases in which the mistaken party is left with a loss which is not eliminated by his co-contractant's declaration that he is willing to abide by the contract as it was understood by the mistaken party.

ARTICLE 16

(1) The fact that the performance of the assumed obligation was impossible at the time of the conclusion of the contract shall not affect the validity of the contract, nor shall it permit its avoidance for mistake.

(2) The same rule shall apply in the case of a sale of goods that do not belong to the seller.

[q] P. 45.

[r] Articles 32 and 48 (1).

COMMENTARY

1. Article 16 serves to delimit the scope of LUV and does not serve as a substantive provision. As a result of article 16 the consequences arising out of the non-performance of an obligation which was impossible at the time of the conclusion of the contract or the sale of goods that do not belong to the seller is to be governed by the substantive law of sales and not by the LUV.

2. The Max-Planck report points out that, "following judicial practice and advanced modern doctrines":

"There appears to be no reason to make the validity of the contract depend upon the accidental fact that the object sold has perished before or after the conclusion of the contract. The impossibility of delivery of the perished goods should leave the door open to determine the rights and obligations of the parties according to the flexible rules on non-performance."[s]

[s] P. 49.

3. The approach taken by article 16 assumes that the doctrines of non-performance in the applicable substantive law of sales would apply to an impossibility of performance existing at the time of the conclusion of the contract. However, the Max-Planck report notes that "most legal systems declare a contract of sale to be void if the specific object sold had already perished at the time of the conclusion of the contract".[t] Similarly article 50 of the draft CISG proceeds on the basis that the impediment to performance which exempts the non-performing party from liability in damages for his non-performance must have occurred after the conclusion of the contract.[u] Therefore, the adoption of article 16 in its current form would leave a gap in the law in many countries between the LUV and the substantive law of sales.

[t] *Ibid.*

[u] A/CN.9/116, annex II, para. 3 of commentary on article 50 (Yearbook . . . , 1976, part two, I, 3).

D. Comments by Governments and international organizations on the draft convention on the international sale of goods (A/CN.9/125 and A/CN.9/125/Add. 1 to 3)*

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Introduction

1. At its second session (3-31 March 1969) the United Nations Commission on International Trade Law established a Working Group on the International Sale of Goods to ascertain, *inter alia*, which modifications of the text of the Uniform Law on the International Sale of Goods (ULIS), annexed to the 1964 Hague Convention, might render such text capable of wider acceptance by countries of different legal, social and economic systems and to elaborate, if necessary, a new text reflecting such modifications.[1]

* 22 March 1977.

[1] *Official Records of the General Assembly, Twenty-fourth session, Supplement No. 18* (A/7618), para. 38, subpara. 3 (*a*) of the resolution contained therein (Yearbook . . . , 1968-1970, part two, II, A).

2. This Working Group completed its mandate at its seventh session (5-16 January 1976) by approving the text of a draft Convention entitled "Draft Convention on the International Sale of Goods".[2]

3. In accordance with a decision of the Commission taken at its eighth session (1-17 April 1975), the text of this draft Convention,[3] accompanied by a commentary,[4] has been sent to Governments and interested international organizations for their comments.

4. All comments received by the Secretariat as at 22 March 1977 are reproduced herein.

5. An analysis of these comments prepared by the Secretariat is contained in document A/CN.9/126.*

I. Comments by Governments

AUSTRALIA

[*Original: English*]

PRELIMINARY

1. The Working Group has succeeded in producing a draft which may well result in a convention capable of achieving much wider acceptance than the 1964 Convention relating to a Uniform Law on the International Sale of Goods.

2. In accordance with the request of the Secretary-General these comments on the draft convention are restricted to fundamental issues arising under the draft convention.

CONFORMITY WITH THE CONVENTION ON THE LIMITATION PERIOD IN THE INTERNATIONAL SALE OF GOODS

3. The approach of the Working Group to the question of conformity with the 1974 Convention on the Limitation Period in the International Sale of Goods is supported. Whilst it is generally desirable that the draft convention conform to the 1974 Convention, the provisions of that Convention should not be emulated at the cost of including in the present draft a provision that is less than appropriate in the circumstances.

OBSERVATIONS ON PARTICULAR ARTICLES

Application. Article 5

4. Careful consideration needs to be given to the question whether the application of the convention to an international sale of goods should be automatic, except to the extent that the parties to the international sale otherwise provide, or whether it should apply only when the parties agree that it apply.

5. States which view the convention quite favourably as a whole may nevertheless have reservations concerning particular issues, having regard to their existing commercial practices. They could be reluctant to accede to the convention if its application is automatic. If it is the case that a significant number of States would find themselves in this situation it may be necessary to provide, in order that the convention receive widespread acceptance, that the convention would apply only if adopted by the parties.

Industrial property claims. Article 7

6. The exclusion from the operation of the convention of any claims that might arise between the buyer and the seller because of the existence in any person of industrial and intellectual property rights significantly diminishes the scope and value of the convention. Where the relationship between the buyer and the seller is otherwise governed by the convention, it is undesirable to leave so substantial an issue to domestic law.

Knowledge

7. Many different expressions dealing with knowledge and constructive knowledge are used in the draft. It is not clear whether some of these are intended to be synonymous or whether they are intended to indicate subtle gradations in states of awareness. In either case, uncertainty and inconsistency of interpretation would appear to be likely consequences of the use of so many different terms.

8. It would be desirable to indicate, preferably by a definition, the standard by reference to which particular states of mind are to be imputed.

Impossibility of performance. Article 50

9. It is considered that the draft convention does not deal satisfactorily with the problems of non-performance due to causes other than fault on the part of the non-performing party. Subject only to a bar in respect of liability for damages the convention treats such non-performance in the same manner as non-performance due to fault, and misperformance (e.g. with regard to the application of the rules as to avoidance and reduction in price). It is thought that quite different considerations should apply in the adjustment of rights between the parties to a contract performance of which is impeded by circumstances for which neither party is responsible from those which should govern their rights where one of the parties has by his own fault been responsible for non-performance or misperformance and so has caused loss to the other party.

10. In particular the present provisions are considered to be inadequate where there is a temporary impediment to performance. The draft convention should take account of the fact that after there has been a temporary impediment to performance, the performance that would then be required of the party in order to carry out his own obligations under the contract may well be radically different from the performance contemplated when the contract was entered into.

Damages. Articles 55, 56 and 57

11. The general principles set out in article 55 for establishing the quantum of damages appear to be reasonable. However, articles 56 and 57 are less satisfactory, in that, as presently drafted, they are apparently intended as alternatives to article 55, rather than illustrations of the operation of article 55 in particular cir-

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* Reproduced in this volume, Section E, below.

[2] A/CN.9/116, annex I (Yearbook . . . , 1976, part two, I, 2).

[3] *Ibid.*

[4] A/CN.9/116, annex II (Yearbook . . . , 1976, part two, I, 3).

cumstances. If the function of damages is to be compensatory, it seems incongruous that three different formulae are provided for the calculation of damages, with the claimant being entitled to select the formula most favourable to him in the particular case.

AUSTRIA

[*Original: English*]

GENERAL OBSERVATION

1. Austria welcomes in principle the draft Convention on the International Sale of Goods prepared by the Working Group on the International Sale of Goods in the frame of UNCITRAL and is of the opinion that this draft is by and large better and more appropriate than the 1964 ULIS.

OBSERVATIONS ON PARTICULAR ARTICLES

Article 9

2. It would be preferable to return to the version contained in article 10 ULIS 1964. The expression "de même qualité" in the French version, which is by the way not contained in the English version and which is on the one hand ambiguous, on the other hand superfluous, should be dropped.

3. If the new version should be maintained, it should be clarified, at which moment the party in breach of the contract must have foreseen the result or must have had reason to foresee it in order to fulfil this condition for the breach being fundamental.

Articles 21 and 29

4. In article 21 (last sentence) it is expressly said that the buyer retains any right to claim damages as provided in article 55. Article 29 (para. 1) does not contain such a disposition. As there is no reason to distinguish between these two articles in this respect, the said disposition should either be contained in both articles or — it is not necessary to mention it expressly — in none of them.

Articles 48 and 49

5. The order of these two articles should be changed for systematic reasons.

Article 50

6. It would be preferable to return in paragraph 1 to the version contained in article 74, paragraph 1 ULIS 1964 in order to avoid the notion "fault" which could lead to a confusion with the terms of "fault" under national laws. As in article 9, the expression "de même qualité" of the French version which again has no counterpart in the English one should be dropped.

7. The whole version could, however, be shortened as follows:

> "(1) If a party has not performed one of his obligations, he is not liable in damages for such non-performance if he proves that it was due to an impediment which he could not reasonably have been expected to take into account or to avoid or to overcome."

8. On the other hand it is proposed to add to the dispositions about the effects of avoidance (before article 51) an article in which the obligation to pay damages is stated fundamentally, in a similar way as the "exemption" in article 50.

Article 54

9. According to paragraph 2 the buyer must account to the seller for all benefits which he has derived from the goods or part of them. It should, however, also be stated that the buyer must account to the seller for all benefits which he reasonably *could* have derived from the goods or part of them.

Article 57

10. In the present version the disposition of paragraph 1 admits a speculation by the party who intends to claim the damages to the detriment of the party obliged to pay the damages. For the party entitled to damages could wait to avoid the contract until the difference between the price fixed by the contract and the current price has reached the maximum. It should therefore be provided that the current price of the moment the delivery was performed or should have been performed is to be paid.

Article 64

11. It should be clarified expressly that only an act of the seller *before* the handing over of the goods can be taken into account.

Article 65

12. Paragraph 2 should be amended in order to express that also in sales involving carriage of the goods the risk passes to the buyer at the earliest at the moment of the conclusion of the contract.

BULGARIA

[*Original: French*]

The Bulgarian competent authorities wish to make the following observations concerning the draft Convention on the International Sale of Goods:

Article 1

1. According to article 1 of the draft, the application of the Convention depends on the parties' "places of business". It should be noted, however, that this concept may have considerable disadvantages in practice. For example, if two enterprises of the same nationality and with the same residence had places of business in different countries, the Convention would be applied. Such an interpretation clearly does not correspond to the aim of the Convention.

The situation would be the same if an enterprise concluded a contract with another enterprise resident in the

same State, but through the intermediary of its place of business abroad.

All these ambiguities regarding the application of the Convention could be eliminated if a much more simple and precise criterion were adopted: residence of the contracting parties in different States — subject, of course, to the conditions specified in article 1, paragraph (1) (*a*) and (*b*).

Article 11

2. While the provisions of article 11 are acceptable in principle, it would have been preferable, in order to make the Convention reflect more closely the various legislative provisions concerning the form and evidence of contracts, to add a second paragraph providing that the contract of sale should be in written form when the legislation of one of the parties so requires.

Article 15

3. According to article 15, subparagraphs (*b*) and (*c*), delivery is made "by placing the goods at the buyer's disposal". This makes delivery a unilateral act. Yet this does not reflect the reciprocal nature of the performance of the contract. Delivery can be made only with the co-operation of the buyer.

It should be noted that "placing at the buyer's disposal" and "delivery" are different acts. In actual fact, "placing at the buyer's disposal" precedes "delivery". Placing at the buyer's disposal is an act of the debtor, in other words of the seller, while delivery is made with the participation of the creditor, in other words of the buyer.

Assimilation of the two concepts could also create difficulties regarding proof. It would therefore be preferable to adopt the ULIS system, whereby delivery consists in the handing over of the goods.

4. The draft Convention differs from ULIS, in which delivery is deemed to have been made only if the goods conform with the contract.

It is reasonable that, if the goods delivered do not conform with the contract, there should be no delivery, since the parties have agreed on clearly specified goods. The requirement of conformity will obviate the need to apply all the rules concerning guarantees in the event that the goods should be faulty.

Chapter VI

5. In accordance with the views expressed above concerning delivery (para. 3 of these observations), the rules in chapter VI of the Convention concerning passing of risk should specify that the risk passes to the buyer when the goods are handed over to him rather than when they are placed at his disposal. In any case, article 66 of the draft Convention should be brought into line with article 15. In our view, the wording of article 97, paragraph 1, of ULIS should be adopted.

AVOIDANCE OF THE CONTRACT

6. The provisions concerning avoidance of the contract seem very complicated from the logical and practical viewpoint. In our view, the principles underlying the rules concerning avoidance should be simplified and should take into account the inequality of the parties resulting from the non-performance of the contract:

(*a*) The party who has fulfilled his obligations under the contract may declare the contract avoided in the event of a fundamental breach.

(*b*) The creditor forfeits the right to declare the contract avoided if he has accepted performance which does not conform with the contract without immediately protesting.

Articles 47 and 49

7. The present wording of articles 47 and 49 does not clearly show the difference between them. It appears to us that article 49 is superfluous, unless it is included in the form of an addition to article 47.

Articles 15 and 65

8. A provision should be added to article 15, subparagraph (*a*), and to article 65, paragraph 1, to the effect that delivery is made and the risk thus passes when the goods are handed over to the first carrier. This would reflect international commercial practice.

Article 57

9. With regard to article 57, we consider that the damages should be assessed at the time of the failure to deliver the goods or at the time when the buyer could reasonably procure the same goods. In our opinion, the present wording of article 57 would allow the seller to speculate in the event of a price increase.

Articles 64 to 67

10. In our view, it seems more logical to place article 64 before articles 65, 66 and 67, since it states the general rule for the passing of risk.

CZECHOSLOVAKIA (A/CN.9/125/ADD. 2).*

[*Original: English*]

GENERAL COMMENTS

1. The draft Convention on International Sale of Goods which has been worked out by the Working Group of the United Nations Commission on International Trade Law represents a good basis for the discussion at the tenth session of the Commission. Deviations from the text of the Uniform Law on the International Sale of Goods of 1964, as proposed by the Working Group, represent for the most part an improvement and basically represent a more unambiguous regulation of rights and obligations of the seller and buyer. In a great number of provisions the draft Convention deviates from the Uniform Law in the same way as, or in a way similar to, the Czechoslovak International Trade Code. Experiences gained by the application of the Czechoslovak International Trade Code provisions since 1963 give evidence for justification of the proposed modifications. In particular, it is necessary to welcome the simplifica-

* 28 April 1977.

tion and greater precision of the concept of the uniform regulation.

COMMENTS ON SPECIFIC ARTICLES

2. However, some provisions of the draft still require re-examination in order to correspond as much as possible to the needs of international trade. This concerns particularly the following problems:

Article 6

3. In the interest of a uniform regulation it would be proper to define in the draft Convention the "place of business" for the reason that this concept can be interpreted differently by individual countries.

Article 8

4. It is arising out of article 8 of the draft, that any usage should have the preference before the provisions of this regulation. Acceptance of this principle would be the source of serious legal uncertainty because none of the participants of the international trade will be certain whether these provisions will not be replaced by usages which are applied in different States differently. It should be also taken into consideration that the developing countries did not have an opportunity to participate in their formation. Due to these reasons, the usages should have preference before the provisions of this regulation only in the case when the contracting parties express their will that the usage will be applied in this manner.

Article 9

5. Even if the difference between fundamental and non-fundamental breach of contract is formulated more properly in the draft than in the Uniform Law of 1964, it seems too vague because the concept of "fundamental breach of contract" is defined by the same vague concept of "fundamental damages". Further, it is doubtful from the economic point of view whether the avoidance of contract (which is the most important legal consequence of the fundamental breach of contract), is to be dependent on the origin of the fundamental loss. The avoidance of contract should enable the entitled person to prevent its occurrence (for example by substitute sale or substitute purchase of goods). On the other hand, after a certain period of time the performance of the obligation may be useless for the entitled person, even if he did not suffer fundamental damage; therefore such person would have the right to declare avoidance of the contract.

6. The criteria for consideration of the fundamental breach of contract should be more properly objectivized by the purpose of the performance of the contract, as long as it has been expressed in the contract, or if it clearly follows from its contents, as for example: "Fundamental breach of contract is such which the party violating the contract has known or was aware of at the conclusion of the contract in view of a motive that the other party would not have concluded the contract had it envisaged its violation, the motive which is expressly contained in the contract or clearly follows from the contract". It would be also suitable to amend the proposed modification with a provision that in case of doubt the breach of contract would not be deemed fundamental.

Article 11

7. Article 11 of the draft Convention should be left out because the form of contract must be discussed in the framework of its formation and a unified regulation concerning this problem will be on the programme of the Commission in the future.

Article 23

8. Even if a failure to send in time a notice of the defective goods is in the majority legal systems combined with the loss of remedies, it would be suitable to consider whether a mere non-recovery would be sufficient. This would simplify the legal consideration of cases where the seller has satisfied the remedies of the buyer (either due to commercial reasons or reasons that defects in the goods have been caused during the production) even if the notice has not been sent in time.

Chapter III (articles 26-33)

9. It would be useful to reconsider the system of remedies which the buyer has in accordance with articles 27 to 33 of the draft. To limit the possibilities of the buyer to request substitute delivery of goods only in case of fundamental breach of contract, according to article 27, paragraph 2, does not correspond with the requirements of practice because the unification should be directed at the performance of the purpose of the commercial operation expected by the parties. The unification should express that the primary remedy of the buyer is the removal of defects, i.e. the repair of goods or substitute delivery. However, the buyer should not have the right to demand the substitute delivery in cases when inadequate costs have arisen for the buyer. Similarly, there may be also cases when, due to the nature of the goods, their repair is ineffective (particularly in some kind of consumer goods). The seller should be protected against such remedy of the buyer if the repair of goods is not possible or represents for him inadequate costs.

Articles 34 and 35

10. The relation between articles 34 and 35 is not quite clear particularly as concerns the results of the opening of a letter of credit. It would be desirable to amend the proposed wording by the provision that if the price is to be paid by a letter of credit or by a cheque, the payment of the purchase should be considered effected only after the payment is performed by the bank to the seller.

Article 50

11. The first sentence of article 50 states responsibility on the principle of "guilt" but the second sentence contains the "objective responsibility" which is more suitable for regulation of international trade. Definition of *force majeure* should be re-examined again and made more precise. Particularly the condition of unforeseeability should be excluded from it because in the cases in

question this condition is usually replaced (or covered) by the condition of an inevitability. However, there can be cases when it is doubtlessly *force majeure* (for example a war conflict) even if the obstacle could have been foreseen (for example in view of certain political situations). Should, in spite of this, unforeseen conditions be left as one of the basic signs of *force majeure*, it would be suitable to state that the time of the origin of obligation is decisive for its consideration. Though the commentary on the draft pre-supposes such interpretation, this conclusion does not clearly follow from the draft.

Article 58

12. It should be reconsidered whether it would be more appropriate for the seller to be entitled to interest charges in the country of the debtor instead of the creditor, or to combine the discount rate of interest valid in both countries in such a way (or manner) that the non-performance of the monetary obligation be advantageous for the debtor (for instance in cases when the rate is higher in his country).

Article 67

13. It is necessary to re-examine whether it is correct that the risk be passed to the buyer also in a case when the delivered goods are defective. Article 67 deals only with cases of fundamental breach of contract, but in accordance with article 30, paragraph 1, letter (*b*) the buyer can, under certain conditions, avoid the contract also in a case of a non-fundamental breach of contract. Here it is also necessary to take into consideration that it is not appropriate that the possibility of avoidance of contract should be limited only on cases of fundamental breach of contract, particularly if its definition contained in article 9 will be preserved.

14. It would be more desirable to have a regulation according to which the risk would be passed to the buyer only in such case if the buyer, in spite of his right to avoid the contract, does not do so without unnecessary delay or does not request a substitute delivery of goods or, if the buyer has no such right at all. In these cases the risk should pass at the time such transition would take place if the goods did not have such defects. Definite consideration on the question of passing of risk is dependent on the solution of the question of legal consequences of the delivery of defective goods and legal claims arising for the buyer in connexion with it.

DENMARK (A/CN.9/125/ADD. 3)*

[*Original: English*]

In the opinion of the Danish Government the Draft Convention on the International Sale of Goods prepared by a working group within UNCITRAL represents an appreciable improvement compared with the Hague Convention of 1964 on the International Sale of Goods.

As the working group has approved the Draft by consensus apart from a very small number of reservations to certain articles it appears that the new convention should be acceptable to states with different legal systems. The Danish Government therefore considers the Draft convention to be an excellent basis for the discussions at UNCITRAL's forthcoming session.

As to the individual articles of the Draft Convention the Danish Government supports the comments made by the Swedish Government.

In addition the Government wishes to submit the following observations.

Article 19

According to paragraph 2 of this article the buyer cannot claim non-conformity of the goods under subparagraphs (*a*) to (*d*) of paragraph 1 if at the time of the conclusion of the contract the buyer knew or could not have been unaware of such non-conformity. This provision seems to be too favourable to the buyer. If the contract provides for specified goods and the buyer has examined the goods at the time of the conclusion of the contract, the seller may reasonably suppose that the buyer has discovered any non-conformity, which could be discovered, and accepted the condition of the goods. The same applies when the seller may reasonably suppose that the buyer has examined the goods before the conclusion of the contract. The wording "knew or could not have been unaware of such non-conformity" should therefore be replaced by "knew or ought to have been aware of such non-conformity".

Articles 26 and 50

The rule of exemption from liability in article 50 paragraph 1 should also apply with regard to an impediment to performance which existed at the time of the conclusion of the contract. In the opinion of the Danish Government there is no reason why the liability of the seller should be more strict in this case than in case of an impediment which has occurred after the conclusion of the contract.

Article 29

As the right of the seller to cure any failure to perform his obligations is limited to cases where no unreasonable inconvenience or unreasonable cost is caused to the buyer and presupposes that the failure can be cured without such delay amounting to a fundamental breach of contract, it is proposed that this right of the seller shall be given priority over the buyer's declaration of avoidance or reduction of the price.

Article 45

Paragraph 2 (*a*) provides that the seller loses his right to declare the contract avoided in case of late performance of the buyer when he becomes aware that the performance has been rendered. If there has been a long delay in the buyer's payment of the price, the performance could be rather surprising to the seller, and it does not seem reasonable that the seller should lose all rights of avoidance when the price is paid. The Government therefore proposes the following wording of subparagraph (*a*):

> "(*a*) In respect of late performance by the buyer, within a reasonable time after the seller has become aware that performance has been rendered;".

* 23 May 1977.

FINLAND

[*Original: English*]

GENERAL OBSERVATIONS

1. The Government of Finland notes with pleasure that the draft Convention on the International Sale of Goods, as elaborated by a working group within UNCITRAL, strikes an equitable balance between the interests concerned and between different legal systems. The draft contains no provision which would be in conflict with the fundamental principles of Finnish law. From the Finnish point of view the draft would form an excellent basis for further deliberations, and a substantial improvement compared with the Hague Convention of 1964 on the International Sale of Goods.

2. The draft could, nevertheless, in the view of the Finnish Government be improved on certain points.

COMMENTS ON CERTAIN ARTICLES IN THE DRAFT

Article 2, subparagraph (e)

3. Taking into account that the Convention would be of a dispositive character (see art. 5) there seems from the Finnish point of view to be no need for the provision proposed under this subparagraph. Ships and aircraft are in principle subject to national rules on sale of goods on an equal basis with other goods. The international régime might as well be applicable to the sale of ships and aircraft where the parties to the contract have left the question open. In most cases these contracts are made on standard terms.

Article 2, subparagraph (f)

4. From the Finnish point of view this provision could be deleted as electricity would not be regarded as goods.

Article 7, paragraph 2

5. Under this paragraph the effect on the relation between the seller and the buyer of the existence of an industrial or intellectual property right is left to national law. National law, however, differs considerably on this point. The proposed text thus leads to an unsatisfactory result. An earlier version of the draft contained a solution to this problem. It is therefore proposed that the introductory language in this paragraph be changed in the following way:

> "Except as otherwise is provided in article 25, paragraph 2, this Convention does not govern . . . (as is)."

Article 10, paragraph 3

6. This paragraph contains a reference to article 23 only when stating which messages are transmitted on the risk of the receiver. The provision should also apply to the provisions of article 16 (1), 27 (2), 30 (2), 45 (2), 48, 49 and 50 (4).

Article 18

7. It seems unclear whether this provision adds anything to the declaration in article 14. Article 18 could therefore be deleted.

Article 22 (1)

8. The words "or cause them to be examined" might lead to confusion as there are several provisions in the draft, where no reference is made to the fact that measures incumbent on a party to the contract might be taken by someone else. The words mentioned might therefore from the Finnish point of view be deleted.

Article 25

9. Attention has been drawn to the fact that this article together with the provision of article 7 (2) would make national law applicable to the effect of an industrial or intellectual right embodied in the goods sold. This problem could be solved by making the seller not liable for such a right in the goods. The problem could also be solved by a provision stating that the seller is responsible to the buyer in respect of rights or claims of a third party based on industrial or intellectual property to the extent such rights or claims arise out of, or are recognized by, the law of the State where the seller has his place of business. This solution would leave the question which industrial or intellectual rights are recognized and whether they could be referred to towards the seller to be determined under national law whilst the effects of such rights would be regulated by the Convention. An industrial or intellectual right would thus be considered as a case of lack of conformity of the goods.

Article 28

10. Under this article the buyer cannot resort to any remedy for breach of contract during the additional period of time. It is submitted that the buyer ought to be entitled to compensation for loss sustained during this period of time. It is submitted that the buyer ought to be should be added to the article:

> "After the period has expired, the buyer may resort to any remedy which is not inconsistent with performance by the seller on the buyer's request."

Article 29

11. As the right of the seller to cure any failure to perform his obligations is limited to cases where no unreasonable inconvenience or unreasonable cost is caused to the buyer and presupposes that the failure can be cured without such delay amounting to a fundamental breach of contract, it is proposed that this right of the seller shall be given priority over the buyer's declaration of avoidance or reduction of the price. There seems to be a tendency in modern law on the sale of goods to preserve the contract, and as this tendency often leads to an over-all reduction of costs, it is proposed that this line of reasoning should be followed here too. This result could be achieved by deleting the text after the words "unreasonable expense".

Article 39, paragraph 1

12. It does not seem clear whether the second sentence of this paragraph adds anything to the first sentence. From the Finnish point of view, the second sentence could be deleted.

Article 44

13. If the proposal to article 28 is adopted, article 44 should be amended correspondingly.

Article 47, paragraph 2

14. The second sentence of this paragraph does not seem to add anything to article 7 and might therefore be deleted.

FEDERAL REPUBLIC OF GERMANY

[*Original: English*]

GENERAL REMARKS

1. The Federal Government welcomes UNCITRAL's efforts to unify the law of the international sale of goods. It is of the opinion that the draft Convention elaborated by the Working Group is a good foundation on which to negotiate at the next UNCITRAL session.

2. In these observations the Federal Government will comment on some provisions which, in its opinion, ought to be improved. These remarks are not to be regarded as exhaustive. The Federal Government reserves submitting further proposals during the UNCITRAL session.

3. Beforehand, it seems adequate to point to a general problem which should deserve special attention during the deliberations on the draft. This draft only settles a part of the legal questions that may arise in connexion with an international sale of goods. Other aspects of this field of law are the subject of the 1974 Convention on Prescription in the International Sale of Goods. Again, other questions are intended to be dealt with in the future Convention on the Formation and the Validity of International Contracts of Sale, which is at present being prepared by the UNCITRAL Working Group on the international sale of goods. It seems to be necessary to take into account the links between all these projects and to avoid discrepancies. Thus, when determining the sphere of application of the draft there should be no deviation from the example set by the Prescription Convention except for cogent reasons. To co-ordinate the draft with the future Convention on the Formation and the Validity of International Contracts of Sale the work on that project should be so speeded up that the latter Convention can be passed at the same diplomatic conference as the Convention on the International Sale of Goods.

COMMENTS ON THE INDIVIDUAL ARTICLES

Article 1, paragraph 1 (b)

4. This provision is met by doubts. The sphere of application of the Convention should be limited to cases in which the parties to a contract of sale have their places of business in different contracting States [art. 1, para. 1 (*a*) of the draft]. If UNCITRAL succeeds in creating a uniform law of sale that is approved all over the world, the number of contracting States will be so great that a wide sphere of application will be assured even without the provision of article 1, paragraph 1 (*b*). The Convention on the Limitation Period in the International Sale of Goods, too, provides only for application as between contracting States.

5. Besides, even without the provision of article 1, paragraph 1 (*b*), it is open to every contracting State to prescribe that in cases in which the rules of private international law lead to the application of the law of this contracting State, the provisions of the international law of sale should be applied to the contract of sale. However, contracting States should not be obliged to introduce such a rule, because this may lessen the readiness to ratify the Convention.

6. It is proposed that article 1, paragraph 1 (*b*) be deleted.

Article 4

7. This provision may give rise to the mistaken belief that an agreement between the parties on the application of the Convention will result in setting aside mandatory provisions of national law also in the case of domestic sales contracts without any connexion to a foreign country. In any case, the provision is superfluous.

8. It is proposed that article 4 be deleted.

Article 7

9. It will have to be examined whether, in addition to the legal fields exempted by paragraph 1, further matters will have to be excluded from the sphere of application of the Convention. For instance, national laws for the protection of the buyer purchasing on an instalment plan and the buyer purchasing "at the front door" should take precedence over the Convention. By the exclusion of the consumer-purchase in article 2 (*a*) and the exclusion of the rules on the validity of contracts of sale in article 7, paragraph 1, most, but not all, of these cases are solved satisfactorily. However, when drafting any such exclusion in consideration of national laws for the protection of consumers, care will have to be taken to preserve the justified interests of international trade in a clear delimitation of the sphere of application.

10. Paragraph 2 does not seem to meet the issue. The question, which legal consequences ensue if industrial or intellectual property rights in the goods sold exist in any third person, should not be excluded from the sphere of application of the Convention. Rather, it appears to be justified to treat such rights of third persons like other rights in the goods sold (cf. article 25 *et seq.*).

11. It is proposed that article 7, paragraph 2 be deleted.

Article 9

12. This provision has not been happily drafted. The term "fundamental breach of contract" is not elucidated by defining it through reference to the vague idea of a "substantial detriment". The decisive point should be whether the result of the breach of contract is that the injured party no longer has an interest in the performance of the contract and whether this could have been foreseen by the party committing the breach at the time of the conclusion of the contract. Only under these conditions does it appear to be justified to grant the right of avoidance of contract which follows from a funda-

mental breach of contract [cf. art. 30, para. 1 (*a*); art. 45, para. 1 (*a*)].

13. Article 9 should read as follows:

"A breach committed by one of the parties to the contract is fundamental *if its result is that the other party has no further interest in the performance of the contract* and if the party in breach, *at the time of the conclusion of the contract,* foresaw or had reason to foresee such a result."

Article 11

14. This provision should remain as it stands. Rigid provisions as to form would run contrary to the requirements of international commerce.

Article 19

15. In this provision also the question should be dealt with upon whom the burden of proof lies in a dispute about the non-conformity of the goods.

16. The following additional paragraph is proposed:

"3. *The seller has to prove that the goods delivered by him conform to the contract. However, if the buyer wants to rely on a lack of conformity which he discovered after the expiration of the period within which he had to examine the goods under article 22, the buyer has to prove this lack of conformity. The buyer is considered to have discovered the lack of conformity before the expiration of this period if he has given the seller notice of the lack of conformity within a reasonable time after the expiration of this period.*"

Article 28

17. It should be made clear that the buyer, by the granting of an additional period of time, does not lose the right to claim damages for delay of performance.

18. The following additional sentence is proposed:

"*However, the buyer is not deprived of any right he may have to claim damages for delay in the performance.*"

19. An analogous addition should be made to article 44.

Article 29, paragraph 1

20. In its last clause the provision provides that the buyer, by the declaration of the reduction of the price in accordance with article 31, may prevent the seller from curing a failure to perform his obligations. Seeing, however, that the right to cure such a failure in any case is subject to the condition that no unreasonable inconvenience is caused to the buyer, this additional limitation does not appear to be proper.

21. It is proposed that at the end of paragraph 1 the words "or has declared the price to be reduced in accordance with article 31" be deleted.

22. In addition, it might be made clear in article 31 that the seller's right to cure failures under article 29 takes precedence over the buyer's right to have the price reduced.

Article 30, paragraph 1 (b)

23. The buyer's right to declare the contract avoided should exist also in the case that the seller does not cure a non-conformity of the goods within a reasonable additional period of time. In many cases, the buyer's interest in the performance of the contract will be infringed upon by defective delivery just as much as by failure to deliver at the agreed time. That quite insignificant defects should be left out of consideration seems to be self-evident and, consequently, to require no express rule.

24. Article 30, paragraph 1 (*b*), therefore, should read as follows:

"(*b*) If the seller has been requested to make delivery *or to cure a lack of conformity* under article 28 and *has not complied with the request* within the additional period of time fixed by the buyer in accordance with that article or has declared that he will not comply with the request."

Article 50

25. In *paragraph 1* there should be no reference to the term "fault" in order to avoid any confusion with the terms of "fault" under national laws.

26. It is proposed that paragraph 1 be shortened as follows:

"1. If a party has not performed one of his obligations, he is not liable in damages for such non-performance if he proves that it was due to an impediment which he could not reasonably have been expected to take into account or to avoid or to overcome."

27. *Paragraph 2* may constitute an unreasonable hardship for the seller. If the seller, as regards his person, is relieved from liability under paragraph 1, his liability for a subcontractor's fault appears to be justified at the most if it is ensured that he can claim indemnity from the subcontractor. Such a claim for indemnity will, however, often fail for reasons of law or of fact, e.g. because of an agreement limiting liability or because of the subcontractor's insolvency.

28. It is proposed that paragraph 2 be deleted.

Article 58

29. The reference to the interest rate applying to unsecured short-term commercial credits seems to be unconvincing. The seller should not be able to claim such a high interest rate in every case of delay in payment of the purchase price, but only if he was actually compelled to take a loan at such a rate of interest. It must moreover be pointed out that interest rates for unsecured short-term commercial credits greatly vary, because lenders take into account the other circumstances under which the credit is granted as well as the customer's creditworthiness.

30. It is proposed that at the end of article 58 the words "but his entitlement is not to be lower than the rate applied to unsecured short-term commercial credits in the country where the seller has his place of business" be deleted.

Article 65, paragraph 1

31. This provision gives no reasonable solution to the case where the seller undertook to ship the goods *from a particular place*. If, for instance, a seller having his place of business in the inland binds himself to provide for shipment of the goods from a particular seaport, the risk should not pass when the goods are handed over to the *first* carrier — who carries the goods to the seaport — but only when they are handed over to the sea-carrier.

32. It is proposed that the following sentence be added to paragraph 1:

"However, if the seller is required to hand the goods over to the carrier at a particular place, the risk does not pass to the buyer before the goods are handed over to the carrier at this place."

HUNGARY

[*Original: English*]

GENERAL OBSERVATIONS

1. The Secretary-General calls the attention to the fact that UNCITRAL "recommended that, as far as possible, comments should be focused on the fundamental issues covered by the draft Convention in view of the fact that Governments and international organizations would again be invited to submit comments on, and amendments to, the draft Convention in connexion with a conference of plenipotentiaries to which the draft Convention, as approved by the Commission, would be submitted for adoption". Accordingly, the comments of the Government of the Hungarian People's Republic are intended to cover the fundamental issues only, and the comments on details will be submitted at the Conference of Plenipotentiaries.

2. The study of the draft Convention has strengthened the earlier view of the Government of the Hungarian People's Republic about the need for the Uniform Law on the International Sale of Goods envisaged by UNCITRAL.

3. An indication of this is that the principle of universality has been manifested throughout the preparatory works of the draft in which countries of all regions have taken part.

4. Another reason which justifies the making of the Uniform Law is that UNCITRAL, in accordance with the task it had set, succeeded in drawing up a draft Convention in which general circumstances rendering the standardization of law difficult have been left aside, and which can expect world-wide acceptance. It contains realistic and practical rules, it has a clear structure, and for the most part its solutions are free from alienating forms understandable only for legal experts.

5. It enhances the commendability of the draft Convention that it creates a proper balance between the two contractual positions.

6. Special mention should be made of the definition of international sale, the stipulation of the scope of application of the Convention, the regulation of the operation of trade usage, the waiving of *ipso facto* avoidance, the definition of the fundamental breach, and the rule of exemption from liability for damages.

IRAQ

[*Original: English*]

The Iraqi authorities have examined the text of the draft Convention on the International Sale of Goods and seen that the draft Convention is relatively close to the principles of the Iraqi Law of Trade No. 149 of 1970.

MADAGASCAR

[*Original: French*]

GENERAL COMMENTS

1. The text of the draft appears to be very comprehensive as it stands and is couched in sufficiently flexible language to enable it to be given practical application in its broad outlines. It therefore calls for only a few basic comments relating to the following articles.

COMMENTS ON SPECIFIC ARTICLES

Article 6

2. Although it is unquestionably difficult to establish a valid criterion for determining which place of business should be taken into account in cases where one of the parties has places of business in more than one State, the formula which has been adopted, namely "the place of business . . . which has the closest relationship to the contract and its performance", does not appear to be completely satisfactory. Greater precision would be advisable, since, as the article now stands, purely subjective considerations must be applied in determining the place of business.

Article 7

3. This article quite correctly restricts the application of the Convention to rights and obligations of the seller and the buyer arising from a contract of sale and excludes, *inter alia*, the effect of the contract on the property in the goods sold and on industrial or intellectual property — questions which very often bring into play purely domestic considerations that vary from State to State and are difficult to resolve.

Article 11

4. On the other hand, although it is true that international contracts of sale can often be concluded by such modern methods as a cable, it is difficult to understand how proof by means of witnesses can be accepted, as provided in this article. That is a very uncertain method, and it is very much to be hoped that the sentence in question will be deleted. Where no other method is possible — which will very rarely be the case — that procedure will no doubt have to be used, but one wonders whether it is necessary to mention it specifically; to do so opens the door to some very risky contingencies, particularly when one considers that any international contract of sale requires, by definition, the spelling out of a number of important particulars (the nature and quality of the goods, the means of payment, the place and date

of delivery, etc.) — questions which are invariably difficult to resolve in favour of one party or the other in the event of a dispute.

NETHERLANDS

[*Original: French*]

GENERAL COMMENTS

1. Before turning to the various parts of the draft Convention, a general observation should be made on the commentary accompanying the draft.

2. The Working Group on the International Sale of Goods had at its task "to ascertain which modifications" of the 1964 Hague Convention relating to a Uniform Law on the International Sale of Goods "might render [that instrument] capable of wider acceptance by countries of different legal, social and economic systems" and "to elaborate a new text" incorporating those modifications.

3. The project does in fact differ from the Hague Convention in a number of rather important respects; moreover, many articles have been deleted even when the modifications made in the system established by the Convention did not require that. However, the commentary on the draft does not always make it clear why these modifications and deletions were thought necessary; very often they fail to indicate, or indicate only in very summary fashion, what will be the practical effects of these differences between the draft and the Hague system. As a result, it is difficult to grasp the precise reasons for some of the modifications made in the original Convention, and this lessens one's understanding of the draft. The commentary should therefore be made more complete on these points.

COMMENTS ON SPECIFIC ARTICLES

Article 1

4. Paragraph (1), in its preambular part and in subparagraph (*a*), provides that the new rules apply by reason of the mere fact that the parties to the contract have places of business in different Contracting States.

5. Article 1 of the Uniform Law on the International Sale of Goods (hereinafter ULIS) requires in addition that the contracts possess one of the international aspects specified in that article. It seems preferable to retain this additional requirement. The system established by the draft Convention implies, for example, that it is applicable to a contract of sale concluded in a country in which the buyer or the seller has his place of business and in which the other party is temporarily present, whereas the delivery of goods already present there must also take place in that country.

6. It is doubtful that such a contract has sufficient international aspects to fall within the sphere of application of the draft Convention.

Article 2

7. On the other hand, it is not made sufficiently clear (page 5 of the commentary on article 2 (*a*)) why it is desirable to exclude from the application of the Uniform Law a contract of sale concluded by correspondence between a sales agency and a buyer having his place of business in another country and thus to make it subject in principle to the legislation of the seller's country.

Article 9

8. In article 9 of the draft, as in article 10 of ULIS, a subjective as well as an objective criterion is used in defining the concept of "fundamental breach". However, the objective criterion is formulated differently in ULIS, which uses the wording, "a reasonable person in the same situation as the other party would not have entered into the contract if he had foreseen the breach and its effects".

9. The draft, on the other hand, provides that the party who committed the breach must have foreseen or had reason to foresee that the breach would result in "substantial detriment to the other party". It is often difficult for one party to know whether "substantial" detriment has resulted or will result for the other party; courts may render widely differing judgements in this regard. The criterion used in ULIS provides greater security for the parties affected by the contract and is therefore to be preferred.

Chapter III (articles 26-33)

10. In chapter III of the draft Convention, the effects of breach of contract by the seller are dealt with in a single section. This presentation is an improvement over the system used in ULIS, which deals with these effects in each instance after setting out the various obligations of the seller. Nevertheless, article 26 of the draft should, like article 34 of ULIS, state specifically that the buyer has no rights other than those conferred on him by the Convention.

Article 15

11. It seems advisable that the obligation to deliver goods which conform to the contract should no longer be regarded as part of the obligation of delivery. It is preferable to regard delivery as consisting solely in the act of placing the goods in the possession or, at least, at the disposal of the buyer.

Articles 30 and 45

12. The draft (articles 30 and 45) provides for avoiding a contract only by means of a declaration made to the other party. The cases in which ULIS recognizes a contract as having been *ipso facto* avoided are thus eliminated.

13. In the case of articles 26, 30 and 62 of ULIS, this makes for greater clarity. A difference of opinion can easily arise as to the date on which the reasonable time referred to in those articles has expired, with the result that it remains uncertain whether and on what date the contract has been avoided. That is not true in the cases envisaged in articles 25 and 61 of ULIS. It will not always be apparent, of course, whether usage requires that the other party make a replacement purchase and whether that is reasonably possible. However, this difficulty should not be overestimated; the buyer and the

seller are engaged in the same type of commercial activity and are generally familiar with existing usage and possibilities or, at all events, are presumed to be familiar with them.

14. Articles 25 and 61 of ULIS — which provide that, if the conditions laid down are met, the contract is *ipso facto* avoided as from the time when the replacement purchase (resale) should be effected — have the advantage that the parties cannot put off at the expense of one of them, with the aid of speculation or price fluctuation, their decision concerning performance or avoidance in cases where a replacement purchase (resale) is in conformity with usage and is possible.

Articles 66 and 67

15. Finally, a comment is called for on the rules relating to passing of the risk. Article 97 of ULIS provides that the risk passes to the buyer when delivery of the goods is effected. If the goods are not in conformity with the contract, however, the risk does not pass to the buyer in the two cases referred to in paragraph 2. These two exceptions are not provided for in article 66 of the draft; on the contrary, under article 67 the buyer retains his right to damages. There is no commentary on this modification. The latter is not required by the change noted above (the fact that, in the draft, the obligation to supply goods which conform to the contract is treated independently of the obligation of delivery), for even under this system the two exceptions to passing of the risk are perfectly conceivable.

16. Thus, if the goods are defective and the buyer declares, citing valid reasons, that he does not wish to keep them, the risk of possible loss or deterioration remains with the seller.

NORWAY

[*Original: English*]

GENERAL OBSERVATIONS

1. The Norwegian Government finds the draft Convention on the whole to be a substantial improvement compared with the ULIS 1964. In particular we are satisfied with the simplified system regarding the sphere of application (art. 1), the exception for consumer sales (article 2 (*a*)), the rules on delivery (articles 15-18) and the consolidated system of remedial provisions for breach of contract (sect. III of chap. III and sect. III of chap. IV).

2. We are confident that the prospects of wide acceptance of the Convention have been considerably improved by the new version compared with the old ULIS 1964.

3. The amendments we nevertheless would like to propose are not of a fundamental character.

4. The provisions of chapter I are to some extent taken from the Prescription Convention 1974. In the interest of harmony such corresponding provisions of the two conventions should not *unnecessarily* differ. Nevertheless, a new formulation on some points may be wanted in the Sales Convention by UNCITRAL and the future Conference of Plenipotentiaries. In order to retain the desirable harmonization between the two Conventions on such points it should be considered to extend the terms of reference of the future conference of plenipotentiaries to include consideration of certain possible amendments to the Prescription Convention (possibly arts. 2, 4, 6 and 7?), consequential to the text of a Sales Convention to be adopted by that Conference.

5. A right of *reservation* should be opened in respect of *The Hague Convention 1955* on the applicable law in the field of international sale of goods, cf. article 4 in that Convention.

AMENDMENTS PROPOSED TO CERTAIN ARTICLES

Article 2

6. Delete subparagraphs (*e*) and (*f*). Alternatively subparagraph (*e*) might perhaps be worded as follows:

"(e) *Of any used ship or vessel which is, at the time of the conclusion of the contract, registered in a national /official/ public register as having a gross tonnage of 10 tons or more;*"

COMMENT

7. In view of the dispositive character of the Convention and its non-application to questions of validity (mandatory law), there seems to be no need to make exceptions for vessels or aircraft. In national laws, contracts for the sale of such vessels or aircraft are subject to the general law on sale. The best and simplest solution is to make no special exception, making thereby the international régime in principle applicable to international sales of vessels and aircraft. As regards the alternative suggestion, one encounters the difficulty of determining and calculating the tonnage, see the 1969 Convention on Tonnage Measurement of Ships. It is suggested that this difficulty may be overcome by referring to the registered tonnage.

Articles 4 and 7

8. In accordance with ULIS *article 4* Norway has earlier suggested that this provision should read:

"The present Convention shall also apply where it has been chosen as the law of the contract by the parties, *to the extent that this does not affect the application of any mandatory provision of law which would have been applicable if the parties had not chosen the law.*"

9. The inclusion of the italicized language was considered by the Working Group on the International Sale of Goods at its second session (A/CN.9/52, paras. 38-41;* see also A/CN.9/100, annex III, paras. 15-17).** The Working Group concluded that the effect of mandatory rules should be dealt with in the general provision of article 8 (now article 7).

10. The present language of *article 7*, however, does not seem quite to solve the problems raised by the amendment proposed to article 4. First, the expression in the *second sentence* of article 7 is probably not broad enough to cover any additional or subsequent agreement between the parties relevant to the sale. Thus, the

* See Yearbook . . . , 1971, part two, I, A, 2.
** See Yearbook . . . , 1975, part two, I, 1.

words "the validity of the contract or of any of its provisions" should be substituted by: "the validity of the contract or of any *provision contained therein or in any other agreement relating to the sale*". Second, article 7 does not — as the amendment proposed to article 4 — solve the choice of law problem involved — i.e. whether article 7 yields to the chosen law, to *lex fori* or to the "law which would have been applicable if the parties had not chosen the law". However, it may be considered that this problem should be left to national law and not be solved in the Convention.

11. Further, in the second sentence of article 7 the two words "In particular" seem misleading in relation to validity (mandatory law) and should be deleted. As regards the validity of a usage, the provision could well be transferred to a new paragraph (3) under article 8.

12. Article 7 may then be worded as follows:

"1. This Convention governs only the rights and obligations of the seller and the buyer arising from a contract of sale. *Except* as otherwise expressly provided therein, *the* Convention is not concerned with:

"(*a*) The formation of the contract;

"(*b*) The validity of the contract or of any *provision contained therein or in any other agreement relating to the sale;*

"(*c*) The effect which the contract may have on the property in the goods sold.

[2. *Except as otherwise provided in article 25 paragraph 2,* this convention does not govern the rights and obligations which might arise between the seller and the buyer because of the existence in any person of rights or claims *relating* to industrial or intellectual property or the like.]"

Article 6

13. The provision in *subparagraph* (c) should be transferred to a new paragraph 3 of article 1 and read:

"3. *The Convention applies regardless of the* nationality or the civil or commercial character of the parties or of the contract."

COMMENT

14. Cf.ULIS article 7. Even if the Convention applies regardless of the character of the parties or the contract, such character may be "taken into consideration" by the courts in certain respects, e.g. by determining what in the circumstances shall be regarded as a reasonable time for giving notice to the other party.

Article 8

15. Add the following as a *new paragraph (3):*

"3. This Convention is not concerned with the validity of any usage."

Article 10

16. The provision of *paragraph 3* should, in principle, apply to notices of lack of conformity (art. 23), of avoidance (arts. 30 (2), 45 (2), 48 and 49), of suspension (art. 47 (3)) or of requirement to deliver substitute goods (art. 27 (2)) and to any notice under articles 16 (1) or 50 (4). It seems not, however, to be important to refer to article 16. The provision should *not* apply to notices under articles 28, 29 ((2) and (3), 44, 46 or 47 (3), second provision "received the notice"). It seems not clear whether the provision should apply to notices under articles 63 ((1) and (2)) or 65 ((2), "discloses").

17. It is submitted that article 10 should read as follows:

"1. *Communications under* [Notices provided for by] this Convention must be made *by means* appropriate in the circumstances.

"2. A declaration of avoidance of the contract is *effected by* notice to the other party.

"3. Where notice of *lack of conformity,* of avoidance *or of suspension* or any notice required by articles *27 paragraph 2 or 50 paragraph 4* is sent by appropriate means within the required time, the fact that the notice fails to arrive or fails to arrive within such time, or that its contents have been inaccurately transmitted, does not deprive the sender of the right to rely on the notice."

Article 25

18. Present article 7 paragraph 2 excludes *industrial or intellectual property rights* altogether from the scope of the Convention. This provision does not seem satisfactory in cases where such rights are embodied in the goods sold, as a concrete claim *in rem*. The consequences of the exclusion of such claims from the scope of the Convention are that the claim and the seller's liability will depend on the law applied by the court seized with the case. Since the laws in this field, as well as the rules on conflict of law, differ much from State to State, the system will create great uncertainties for the parties. A better solution may be to provide that the seller is responsible to the buyer in respect of rights or claims of a third person based on industrial or intellectual property [only] to the extent that such rights or claims (relative to the goods) arise out of, or are recognized under, the law of the State where the seller has his place of business (including any international convention recognizing such rights or claims, to which that State is a party). Such a provision could be placed in article 25 as a *new paragraph 2* to read as follows:

"2. *Whether a right or claim of a third person based on industrial or intellectual property amounts to a breach of contract by the seller, is determined according to the contract and the law of the State where the seller has his place of business at the time of the conclusion of the contract. The effects of such a breach are determined by the provisions on lack of conformity in this Convention.*"

19. The question arises what *remedies* the buyer shall have for breach of the seller's obligations under article 25 (cf. old ULIS arts. 52 and 53). It is clear that he will have the remedies under articles 26 to 33 (and 47 to 49), except the remedy under article 30 paragraph 1 (*b*) and perhaps remedies under articles 27 paragraph 2, 31 and 32. If it is understood that third party claims under article 25 shall be deemed to constitute a lack of conformity, the provisions under articles 27 (2), 31 and 32 would apply, as they should. It is then a remaining matter of policy whether article 30 (1 *b*)

on avoidance after the *nachfrist* should be extended to cases under article 25. It is submitted that this is not justified, in particular since the third party claim may be more or less well founded.

20. Consideration should also be given to the relation between article 25 and the preceding articles in the same section II, in particular the relation to article 23 paragraph (2). Cf. ULIS 1964 articles 52-53.

Article 26

21. Add the following as a *new paragraph 3* (between the present paras. 2 and 3):

"3. *The rights conferred on the buyer by this Convention exclude all other remedies based on lack of conformity of the goods /or on other failure by the seller to perform his obligations/, except in case of fraud.*"

COMMENT

22. Cf. ULIS 1964 articles 34 and 53. The provision is even more important under the system of the new Convention, which is not a system of uniform law in a strict sense. It is intended to preclude in cases of lack of conformity that the buyer relies on remedies under *national* law which are not considered as remedies for breach of contract, for instance remedies relating to error, mistake, misrepresentation or the like. This point of view applies in principle also to cases of delay and other cases of failure by the seller to perform his obligations (cf. ULIS 1964 art. 53). However, it is felt that any remedy under national law based on tortious fraud shall be available to the buyer (cf. comments *infra* on possible new art. 59 *bis* on fraud).

23. If it is felt that a provision as proposed should be limited to cases of lack of conformity — as the problem of practical importance — the proposed provision with such limited scope could preferably be inserted as a new paragraph 3 in article 19. In this connexion reference is made to the fact that in ULIS 1964 a corresponding provision is found in article 34, immediately after ULIS article 33 which corresponds to the present draft article 19.

Article 27

24. The time limit in paragraph (2) for requesting substitute goods should be given a wider scope and made applicable to any request for performance in cases where the seller has made delivery but where the goods do not conform with the contract. If the right to request performance is unlimited in time (according to arts. 27 and 28), this right might be abused by the buyer for the purpose of evading the time limits for avoiding the contract under article 30 paragraph (2) (*b*).

25. The following wording of article 27 is proposed:

"1. The buyer may require performance by the seller unless he has resorted to a remedy which *is inconsistent with* such requirement.

"2. *If the seller has made delivery, but the goods do not conform with the contract, the buyer loses his right to require performance, unless such request is made either in conjunction with notice given under article 23 or within a reasonable time thereafter.*

"3. If the goods do not conform with the contract, the buyer may require delivery of substitute goods only *where* the lack of conformity constitutes a fundamental *breach.*"

Article 28

26. This article should read:

"1. *Subject to the provisions of article 27,* the buyer may *fix* an additional period of time of reasonable length *for performance by the seller.* During such period the buyer cannot resort to any remedy, unless the seller declares that he will not comply. *After the period has expired, the buyer may* resort to any remedy which is *still open to him and not inconsistent with performance by the seller of the buyer's request.*

"2. *Where the buyer requests the seller to perform, without fixing an additional period referred to in paragraph 1, the request is assumed /, for the purpose of the provisions thereof, / to include the fixing of a period of reasonable length.*"

COMMENTS

27. The main purpose of this article is not to provide for a right to request performance (cf. art. 27), but to regulate the buyer's power to fix (or grant) an additional period for performance (a "*nachfrist*"). This purpose should come more in the forefront of the text (cf. old ULIS art. 44 (2)).

28. To avoid uncertainty it should perhaps be expressly stated, not only what the buyer cannot do during the fixed period, but also what he can do after the period has expired (cf. old ULIS arts. 42 (2) and 44 (2)), whether or not the seller then has performed. If the seller performs within the period, it would presumably be inconsistent with the request to avoid the contract because of the delay.

29. The suspending effect of the fixed period in respect of the buyer's right to exercise remedies should apply also where the buyer requests the seller to cure a breach, without expressly fixing a specified period of time (cf. the corresponding provision of art. 29 para. 2). This is a practical case and the buyer should then wait a reasonable time before eventually declaring avoidance or price reduction (and perhaps also before collecting damages?). It is, however, a further question whether such a period of unfixed reasonable time should be given the effect of a *nachfrist* in relation to the right of avoidance under article 30 paragraph 1 (*b*). If not, the provision on the purely suspending effect of the unfixed period may, for convenience of drafting, be placed in a separate *new paragraph 2* of article 28.

Article 30

30. If the proposal of adding a new paragraph (2) in article 28 is adopted, on the understanding indicated above in the comments thereto, the reference in *paragraph (1)* (b) of article 30 should apply only to paragraph (1) of article 28. *Paragraph (1)* (b) should then read:

"(b) *in case of non-delivery,* if the seller *does* not deliver the goods within the additional period of time fixed by the buyer in accordance with article 28 *para-*

graph 1 or declares that he will not comply with the request *to make delivery*."

31. *Paragraph (2)* (b) should refer also to article 29 paragraph (2), for instance so:

"(b) in respect of any other breach than late delivery, after he knew or ought to have known of such breach, or *after the expiration of any additional period of time applicable under articles 28 or 29*."

Article 44

32. If the proposals in relation to articles 28 are adopted, article 44 (and art. 45 para. 1 (*b*)) should be amended correspondingly. Furthermore, the buyer's right of interpellation, and the consequences thereof, should also be provided for, cf. article 29 paragraphs 2 and 3. Article 44 would then read as follows:

"1. The seller may fix an additional period of time of reasonable length *for performance by the buyer. During* such period the seller cannot resort to any remedy, unless the buyer declares that he will not comply. *After the period has expired, the seller may resort to any remedy which is not inconsistent with performance by the buyer of the seller's request.*

"2. *Where the seller requests the buyer to perform, without fixing an additional period referred to in paragraph 1, the request is assumed, for the purpose of the provisions thereof, to include the fixing of a period of reasonable length.*

"3. *Where the seller has not requested performance, the buyer may request the seller to make known whether he will accept performance. If the seller does not comply within a reasonable time, the buyer may perform within the time indicated in his request, or if no time is indicated, within a reasonable time. The seller cannot, during either period of time, resort to any remedy which is inconsistent with performance by the buyer. A notice by the buyer that he will perform within a specified period of time or within a reasonable time is assumed to include a request under this paragraph that the seller make known his decision.*"

Article 45

33. It is proposed to draft *paragraph 2* as follows:

"2. However, in cases where the buyer has paid the price the seller loses his right to declare the contract avoided if he has not done so:

"(*a*) In respect of *late payment*, before the seller has become aware that *payment* has been *made;* or

"(*b*) In respect of any other breach than *late payment*, within a reasonable time after the seller knew or ought to have known of such breach, *or after* the expiration of *any additional* period of time applicable under article 44."

COMMENT

34. The drafting of the present *subparagraph* (*a*) of paragraph 2 is objectionable in so far as it keeps open the right of avoidance based on late performance until performance has been rendered, both in respect of payment and in respect of taking delivery. Are there other possible delays in the buyer's performance than delay in payment or in taking delivery? If so, such delay in performance should probably come under subparagraph (*b*), not under (*a*) as in the present draft.

35. The system (both in the present text and as proposed *supra*) is that the right of avoidance is kept open as long as payment in whole (of all instalments) has not been made, see the initial phrase: "where the buyer has paid the price". This applies also in respect of the buyer's delay in taking delivery. It furthermore applies to any breach of the buyer's obligations to make provision for assuring or guaranteeing payment (by bill of exchange, documentary credit etc.), cf. article 35 and old ULIS article 69. A fundamental breach of such obligations gives the seller the right to avoid for the unlimited period of time until (full) payment is made.

36. *After* payment has been made, however, the situation is and ought to be another. Under the proposed text (contrary to the present text) it will then invariably be too late for the seller to declare avoidance in respect of delay in payment. As regards delay in taking delivery one might contemplate two alternative solutions, either to apply the rule formulated in the proposed subparagraph (*a*) or the rule in subparagraph (*b*). Under the first alternative it would, after received payment, be too late for the seller to declare avoidance in respect of the buyer's delay in taking delivery. This would apply even if the buyer never takes delivery after payment, and even if the seller has fixed a *nachfrist* under article 44 for the purpose of obtaining the right to avoid under article 45 paragraph 1 (*b*). The seller would have to resort to other remedies, such as damages and/or steps under articles 62-63. Under the second alternative the rule in paragraph 2 (*b*) would apply and in particular enable the seller to use the *nachfrist* for the purpose of possible avoidance, even after he has received payment. Both alternatives may seem acceptable, but the second one is deemed to be preferable and is proposed in the text above.

37. It would seem implied in the system that any right of avoidance because of previous failure in respect of payment guarantees could not be declared after received payment (in the present text: after performance). But avoidance within a reasonable time after discovery of the breach will be open under subparagraph (*b*) in respect of other breaches, e.g. as regards place, currency and manner of payment. Payment of the price in case of disputed amount is in an intermediate position and may be left to the courts. (Otherwise, payment or performance presumably means payment or performance in whole.)

Article 46

38. The last sentence of *paragraph 2* should read:

"If the buyer fails to do so *after having received the request*, the specification made by the seller is binding."

Article 48

39. *Paragraph 1* of this article states that breach in respect of any one instalment may constitute an anticipatory breach and give the other party reason to avoid the contract for the future (as regards future instalments). *Paragraph 2* states that avoidance in respect of future deliveries may be extended to deliveries already made if they are interdependent. It should also be provided for the possibility of extending an avoidance of any

made delivery (instalment) to previous deliveries (cf. old ULIS art. 75 para. 2), in particular where it is the last delivery that is avoided. Paragraph 2 could then be drafted as follows (alternatively be transferred to art. 32 as a new para. 3?):

"2. If a buyer *avoids* the contract in respect of *any delivery* [*under a contract for delivery of goods by instalments*] *and if*, by reason of *the* interdependence *with such delivery, other previous or future deliveries cannot* be used for the purpose contemplated by the parties in entering into the contract, *the buyer* may also, provided that he does so at the same time, declare the contract avoided in respect of *such previous or future deliveries*."

Article 50

40. The provision of *paragraph 1* should be drafted more objectively (cf. old ULIS art. 74), for instance as follows:

"1. Where a party has not performed one of his obligations he is not [*shall neither be required to perform nor be*] liable in damages for such non-performance if he proves that it was due to an impediment *beyond his control and of a kind which a party in the same situation could not reasonably be expected neither to take into account* at the time of the conclusion of the contract *nor* to avoid or overcome."

41. *Paragraph 3* should be extended to provide for the practical case where a temporary impediment may entail permanent relief (cf. old ULIS art. 74 para. 2), and read as follows:

"3. The exemption provided by this article has effect for the period during which the impediment existed. *However, the party concerned shall be permanently relieved of his ability /obligation/ if, when the impediment is removed, the performance has so radically changed as to amount to a performance quite different from that contemplated by the contract.*"

42. The consequences of the relief will depend on whether or not the failure to perform under article 50 is deemed to be equal to a breach of contract. If this question is not solved in the Convention, it will depend on national laws, which differ greatly on this point. It should therefore be made clear (in the form of an express reminder) that the other party may apply the provisions on avoidance or price reduction, and, if so, that the provisions of article 50 apply to both parties. Cf. old ULIS article 74 paragraph 3. It is proposed to add the following as a *new paragraph 5:*

"5. *Nothing in this article prevents a party from avoiding the contract or reducing the price in accordance with the provisions of this Convention on account of a failure by the other party to perform any of his obligations.*"

Articles 56 and 57

43. *Articles 55-57* set out three alternative methods for the calculation of damages for breach of contract in case of avoidance. The text of articles 56 and 57 seem to suggest that the claimant shall have a free choice between these remedies, and this point is brought out even more forcefully in the commentaries on article 56 (note 4) and on article 59 (note 3). Articles 55-57 will, of course, have to be read in conjunction with article 59 imposing upon the injured party a duty to adopt reasonable measures to mitigate the loss resulting from a breach. However, the Norwegian Government considers — without accepting as correct the interpretation of these articles set out in the commentaries referred to — that the strong emphasis on this free choice of the claimant may open up for an interpretation of article 59 which will reduce the duty of the claimant to mitigate the loss, far beyond what is today the law in many countries. The net effect of articles 55-57 and 59 can consequently in particular cases be that the claimant is entitled to recovery in excess of his loss as established after appropriate measures to mitigate the loss have been or should have been taken. For these reasons and in accordance with the views expressed below, the Norwegian Government proposes that the reference to article 55 contained in article 56 (1) and in article 57 (1) should be deleted.

44. If a substitute transaction has been made, article 56 (1) allows recovery of the price difference so established, while article 56 (2) allows recovery of additional items of loss in accordance with article 55. In view of this, the reference to article 55 contained in article 56 (1) seems to suggest that even in respect of the price difference a higher amount may be recoverable under article 55. However, this would be tantamount to recovery in excess of the loss in terms of a price difference actually established. Even if the claimant brings his claim under article 55, the price difference established by the substitute transaction must necessarily be a main item in calculating his individual loss. Consequently, the reference to article 55 contained in article 56 (1) should be deleted as misleading.

45. If the claimant does not want to disclose a substitute transaction or if for commercial reasons, it is difficult to conclude that a transaction of the claimant is in fact such a transaction, he may of course choose not to invoke article 56. In that case he may, on the other hand, invoke article 57 to recover in respect of the price difference in the amount set out in article 57 (1). The reasons for making article 57 an alternative to article 56 are consequently appreciated. Again however, article 55 appears as a further alternative. In light of article 57 (3), referring to article 55 as regards recovery of items of loss other than the price difference, the reference to article 55 contained in article 57 (1) can have an independent significance only if the recovery in respect of the price difference may be higher under article 55 than under article 57 (1). It should be kept in mind that the case under consideration is not one where a substitute transaction is proven and invoked by the claimant. This being so it is suggested that the reference to article 55 contained in article 57 (1) should be deleted.

46. Article 57 (1) allows recovery of the price difference as of the date of avoidance, and applies only when the goods may be sold or bought at a current price. Having decided to avoid the contract, the claimant may consequently avoid any further loss in respect of the price difference than that referred to in article 57 (1) by appropriate substitute transaction, cf. article 59. If he fails to do this and the market subsequently rises, he and not the party in breach should bear the consequences. In other words article 55 should not be alternative in the sense of allowing a higher recovery in respect of the price difference than article 57 (1). It is submitted that even if

calculating in such a case the damages under article 55, the result will be the same if due account is taken of article 59. In light of this, the reference to article 55 contained in article 57 (1) — suggesting a ground for higher recovery — is misleading and should be deleted.

47. In *conclusion* the Norwegian Government considers that the key question relevant to articles 55-57 and 59 is the extent of recovery in respect of the price difference. In the cases referred to in article 56 (1) and article 57 (1), the provisions of article 55 should not constitute an alternative basis for any higher recovery in respect of such loss. Other items of loss will of course be governed by the rules of article 55, cf. articles 56 (2) and 57 (3), read in conjunction with article 59.

48. Consequently the Government *proposes* to delete the reference to article 55 contained in articles 56 (1) and 57 (1).

49. In article 56 (1) an alternative drafting may be to substitute the words: "if he does not rely upon the provisions of articles 55 or 57" by the following: "as part of the damages referred to in article 55". (The provision in para. (2) of art. 56 should then be deleted as superfluous.) The claimant's option to invoke either article 56 or article 57 would follow from the wording in article 57.

Article 59

50. Add the following as a *new second sentence:*

"These measures shall include, where appropriate, notice within a reasonable time to the party in breach for the purpose of enabling him to mitigate the loss."

COMMENT

51. The proposed provision on notice within a reasonable time to the party in breach seems reasonable in cases where that party may otherwise be unaware of the breach or the consequences thereof to the other party. A notice will put the party in breach in the position that he may himself adopt measures to mitigate the loss resulting from the breach and thereby reduce his liability in damages. This may be of practical importance in cases where the party in breach is in a better position than the other party to adopt measures to mitigate the loss. There is a particular need for such a provision in cases where damages may be claimed for late delivery (non-delivery included) or other delayed performance, without avoidance of the contract, because there is no provision in such cases corresponding to the provisions on notice in articles 23 and 30.

POSSIBLE NEW ARTICLE 59 BIS ON FRAUD

52. The Working Group has decided to *delete* the provision in old ULIS article 89, which refers the determination of damages in case of *fraud* to national law on contracts on sale not governed by the Uniform Law. The considerations behind this decision seem mainly to have been the following:

(*a*) The need for uniformity;

(*b*) No imperative necessity to modify the limitation of damages provided by the foreseeability test in article 55;

(*c*) To avoid the possible misinterpretation of the old article 89 that the party who is the victim of fraud shall not in any event be entitled to damages at least equal to those which he would have recovered by the simple application of articles 55 to 59.

53. The deletion should be *reconsidered,* taking into consideration, *inter alia,* that the old article 89 deals with fraud on the part of any one of the parties, the victim as well as a fraudulent party claiming damages for a breach by the other party. The provisions of articles 55 to 57 seem to need a correction for cases of fraud committed by the claimant. Cf. also articles 25 and 50. It should also be taken into consideration that the convention does not govern and cannot unify the effect of fraud regarded as a tort independent of contract, in particular where the fraud is committed before or during the conclusion of the contract. It should be made clear whether, and in what way, the Convention regulates the effect of fraud in performance of the contract. Cf. the proposed amendment to article 26 and comments thereto.

Article 65

54. In *paragraph 2* regarding goods in transit it should be made clear that the provision presupposes that the goods, when handed over to the carrier or later, have been separated or otherwise identified for transmission (delivery) to some (specified) person (or consecutive consignees), i.e. either the seller or another predecessor of the buyer. (Cf. prof. Tunc's commentary on old ULIS art. 99.) The provision should not apply to unascertained and unidentified goods in bulk transmission to different consignees whose parts in the goods are not separated. It is proposed to draft paragraph 2 as follows:

"2. *Where the contract of sale relates to* goods already in transit, the risk *is borne by the buyer as from* the time *when such* goods were handed over to the first carrier *for transmission to the seller or another consignee.* However, the risk of loss of goods sold in transit does not pass to the buyer if, at the time of the conclusion of the contract, the seller knew or ought to have known that the goods [*or part thereof*] had been lost or damaged, unless the seller discloses such fact to the buyer."

55. As regards possible *new paragraph 3* see A/CN.9/WG.2/WP.25.

Article 66

56. It is proposed that this article should read as follows:

"1. In cases not covered by article 65 the risk passes to the buyer *when* the goods *are* taken over by him or, *where he has not done so in due time, from the earlier moment when the goods have been placed at his disposal and he has committed a breach of contract by failing to take delivery.*

"2. *If, however, the buyer is required to take over the goods at a place other than any place of the seller, the risk passes when time for delivery has come and the buyer is aware, or has received notice, of the fact that the goods are placed at his disposal at such place.*

"3. Where the contract relates to a sale of goods not then identified, the goods are deemed not to be placed at the disposal of the buyer until they have *been separated or otherwise* clearly identified to the contract."

COMMENT

57. *Paragraph 1* amalgamates the present paragraphs 1 and 2 first sentence. The present text is somewhat confusing because, while it would appear that the risk in any event passes when the goods are taken over by the buyer that conclusion is weakened by the cumulative reference to the seller placing the goods at the buyer's disposal.

58. *Paragraph 2* is new and takes care, *inter alia*, of situations where delivery is effected in accordance with present article 15 subparagraph (*b*), e.g. where the goods are held by a bailee or a warehouseman. Cf. ULIS articles 23 (2) and 97 (1). See also the report of the Working Group from its fifth session (A/CN.9/87)* under paragraphs 236-238. Even if the time (period) for delivery has come, this does not necessarily imply that it is a breach of contract by the buyer to omit to collect the goods without delay. If the place for collection (delivery) is a place of the buyer or of a third person, it seems reasonable that the risk passes immediately when the goods have been placed at the buyer's disposal at such place (and this is made known to him). If, however, the place of delivery is a place of the seller, it may be more reasonable or rational (insurance etc.) that the risk does not pass until the delay amounts to a breach of contract.

59. The proposed paragraph 2 is based on the assumption that the concept "taken over" in paragraph 1 is limited to taking physical possession. Where goods are in the hands of a third person, it has however, been suggested that the buyer "takes over" the goods when an appropriate act has occurred after which the third person is responsible to the buyer for the goods (and that the risk in such cases passes even before the buyer has committed a breach of contract by failing to take over the goods physically). It has been submitted that such appropriate act includes the handing over of a negotiable document of title (e.g. negotiable warehouse receipt) or the acknowledgement by the third person that he holds the goods for the benefit of the buyer. This interpretation would bring about uncertainties in applying the concept "take over" and seems not justified by the current text. But the problem behind calls for a clear provision.

60. *Paragraph 3* corresponds to present paragraph 2 second sentence.

PAKISTAN

GENERAL OBSERVATIONS

General specific contract specimen

1. It would be useful and desirable if in the light of this Convention, the United Nations Commission on International Trade Law drew up a general/specific contract specimen for use in international trade.

2. Similarly, it would be efficacious if the member nations were advised to create inspection/examination bodies in their respective countries in collaboration with the Chambers of Commerce and Industry for the checking of quality, quantity, packing, delivery, conformity with samples, etc. Such agencies should be empowered to check and issue clearances and in the event of any complaint or loss thereafter, the inspection agency and seller should be held responsible for it.

COMMENTS ON PARTICULAR ARTICLES

Article 1(2)

3. The place of business of the parties should be clearly defined to prevent triangular business which occurs in the case of re-export to a third State by the buyers.

Article 6(b)

4. Clearly defining a place of business, instead of making reference to habitual residence, is necessary.

Article 10(2)

5. For declaration of avoidance of contract the notice given by a party should be well in advance in order to assess reasons for the avoidance of contract and to evaluate its genuineness.

Article 11

6. If a contract of sale is not evidenced by writing then the witness should be their Chambers of Commerce or Associations of trade concerning the commodity in question.

Article 14

7. The original documents should preferably be routed through authorized commercial banks to ensure realization of the amount in question.

Article 15(c)

8. The place of delivery should be clearly defined in the contract to avoid any misunderstanding.

Article 17

9. A clause may be added to this article to explain reasons in case of delay.

Article 20(1)

10. It would be appropriate if the responsibility for lack of conformity rested with the Inspection agency concerned and the seller.

Article 22(2)

11. Examination before shipment of goods is preferable. Ex-destination examination may cause expense and complications.

Article 23(1)

12. The term "reasonable time" wherever it occurs in the draft should be clearly determined and defined.

Article 23(2)

13. Two (2) years time is too long a period as goods will lose their resale value. It is advisable to carry out inspection at the time of unloading.

* See Yearbook . . . 1974, part two, I, 1.

Article 26(2) and (3)

14. Provided it is included in the contract.

Article 31

15. Reduction in price should be clearly defined in contract or mutually agreed upon thereafter.

Article 36

16. The basis of price determination should be clearly defined in the contract.

Article 39(3)

17. The examination time-limit of goods must be defined.

Article 57(2)

18. In calculating the amount of damages "invoice value" should preferably be the basis.

Article 63(1) and (3)

19. It is reasonable to determine a time-limit and the other party should be duly intimated. Preservation cost should also be intimated to the buyer by the seller.

PHILIPPINES

[*Original: English*]

GENERAL OBSERVATIONS

1. All the articles should have titles. For example: *Article 1. Application of the Convention; Article 2. Sales not covered by the Convention, etc.*

OBSERVATIONS ON PARTICULAR ARTICLES

Article 1

2. It is suggested that in order for this Convention to apply, the parties must not only have places of business in different States but must be of different nationalities.

3. Thus, a Filipino whose place of business is in New York, and another Filipino whose place of business is in Tokyo, shall, in contracts of sale between them, be governed not by this Convention but their own national law. Hence, it is proposed that paragraph (1) of article 1 should read: "(1) This Convention applies to contracts of sale of goods entered into by parties of *different nationalities* whose places of business are in different States:"

Article 2

4. The term "goods" should be defined in order to determine what goods will not be subject to the Convention. The exclusion of "ships, vessels, and aircraft" from the application of the Convention seems unjustified. The general provisions of the Convention may be applied to them, subject to the special requirements imposed by special laws governing them.

Article 5

5. We suggest the addition after the term "exclude" of the following words: "by express stipulation" in order to indicate clearly that "implied" exclusion, derogation or varying of any of the provisions of the Convention, is not recognized. Article 5, as amended, should read as follows: "The parties may exclude by express stipulation, the application of this Convention or derogate from or vary the effect of any of its provisions."

Article 6

6. If our comments on article 1 regarding the taking into account of the nationality of the parties in the application of the Convention is favourably considered, then, paragraph (*c*) of article 6 should read as follows: "(*c*) Neither the civil or commercial character of the parties or of the contract is to be taken into consideration."

Article 9

7. We suggest the deletion of the last portion of the article: "and the party in breach foresaw or had reason to foresee such a result." Unless so deleted, the party in breach will always allege to exempt himself from liability that he did not foresee and had no reason to foresee "substantial detriment" to the other party. It is sufficient that a "substantial detriment", as a fact, resulted from the breach; it is quite difficult to prove further that the party in breach "foresaw or had reason to foresee such a result". This will practically allow exemption of the party in breach from liability for breach of the contract as it would be easy for him to allege his ignorance of such substantial detriment but difficult for the injured party to prove otherwise.

Article 11

8. An international sale of goods is presumed to involve a value greater than 500 pesos (Philippine currency, ₱), equivalent to approximately $US70. Under Philippine law, any sale of goods at a price not less than ₱ 500 must be evidenced by writing, note or memorandum, in order to be *enforceable*. It is suggested that a contract of international sale of goods should always be in writing or evidenced by some note or memorandum of some sort, or exchange of telegrams or the like. This requirement would give certainty to commercial contracts and would prevent unnecessary litigations. Hence, it is proposed that article 11 should read as follows:

> "A contract of sale *to be enforceable must be evidenced by writing, note, or memorandum signed or acknowledged by the parties or their authorized agents, although it need not be subject to any* other requirements as to form. It may be proved by means of proof generally recognized by the law of evidence."

Article 16

9. The preposition "to" in article 16, paragraph (1) should be changed to "in" so as to read: "or are not otherwise identified IN the contract, . . .".

Article 43

10. We suggest the insertion after "seller" in the first line, of the words "after he has duly complied with his obligation under the contract," so that said article will read as follows:

"The seller, AFTER HE HAS DULY COMPLIED WITH HIS OBLIGATION UNDER THE CONTRACT, may require the buyer to pay the price, take delivery or perform any of his other obligations, unless the seller has resorted to a remedy which is inconsistent with such requirement."

POLAND

GENERAL OBSERVATIONS

1. The Government of the Polish People's Republic is of the view that the draft convention on the international sale of goods prepared by the UNCITRAL Working Group properly reflects a balanced and carefully elaborated compromise between the interests of both parties to a contract of sale of goods.

OBSERVATIONS ON PARTICULAR ARTICLES

2. There are, however, a few matters which are susceptible to improvement.

Article 50

3. One of the most important problems for parties to a contract of sale of goods is the problem of changes of circumstances which could not have been foreseen by them at the conclusion of a contract.

4. Such changes can result in excessive difficulties for the parties or threaten them with considerable damage when performing the contract.

5. Therefore, it seems reasonable to include in the draft a provision dealing with the principle *rebus sic stantibus* according to which any party will have a right to renegotiate conditions of a contract.

6. Thus the following provision should be included after article 50 of the draft:

"If, as a result of special events which occurred after the conclusion of the contract and which could not have been foreseen by the parties, the performance of its stipulations results in excessive difficulties or threatens either party with considerable damage, any party so affected has a right to claim an adequate amendment of the contract or its termination."

Article 13

7. It seems advisable to precede article 13 of the draft by a general clause to the effect that in the interpretation and application of the stipulations of a contract, the intention of parties as well as the purpose they wish to achieve are to be taken into account.

8. The rationale of the foregoing suggestion is as follows:

The draft convention deals with a contract of sale of goods. In case of a dispute, the stipulations of the contract concerned are to be examined. If any of the said stipulations gives rise to doubts, the court when considering a case should try to clear up the intention of the parties at the conclusion of the contract. The court should also consider what the parties wanted to achieve, i.e. what was the purpose of the contract.

Additional article: Choice of Law

9. The draft Convention does not indicate the law which is to be applied to the contract when the contract does not contain an appropriate stipulation to this effect. This problem is closely connected with the question of the conflict of laws. It seems therefore advisable to supplement the draft by a provision that, unless the parties agree otherwise, the law of the seller's country is to be regarded as the proper one with respect to a contract of sale of goods. It is justified by a quite common recognition of this principle in the international trade.

Additional article: Penalties

10. It seems also advisable to include in the draft a provision concerning penalties. This will facilitate, to a considerable degree, any claim of damages for a breach of contract.

11. Regulation of the question of penalties in the draft will also eliminate the existing lack of uniformity in this field in the various legal systems.

Article 10

12. Attention should also be drawn to the provisions of article 10, paragraph 3 according to which the addressee bears consequences when the notice fails to arrive within the required time or that its contents have been inaccurately transmitted. This provision ought to be amended in order to balance the rights and obligations of the parties to a contract of sale of goods.

SWEDEN (A/CN.9/125/ADD.1)*

[*Original: English*]

GENERAL REMARKS

1. For international trade transactions to function smoothly, it is desirable that States should as far as possible apply the same substantive rules in respect of international sales. The work carried out within UNCITRAL with a view to achieving a convention in this field is therefore most important.

2. In the opinion of the Swedish Government the draft Convention prepared by the Working Group constitutes a suitable basis for future work. The draft must be regarded as a considerable improvement on the 1964 Hague Convention relating to a Uniform Law on the International Sale of Goods (ULIS).

3. One general criticism can, however, be made of the draft, namely a certain lack of clarity and precision. None the less, it is clear that a fairly high level of abstraction and vagueness is inevitable in rules that are to apply to a large number of States whose legal, social and economic systems differ. The Swedish Government is in favour of revising the text to make it as clear and stringent as possible.

* 30 March 1977.

STRUCTURE OF THE DRAFT

4. One basic feature of the draft is that the remedies for breach of contract by the seller are dealt with together in one section and that the remedies for breach of contract by the buyer are dealt with together in another section. Contrary to the rules of the Nordic legal systems, failure by the buyer to pay the price for goods is equated with failure to take delivery of goods. As a result, the seller in the latter case can declare the contract avoided even if the buyer has paid the price. Here it would be enough for the seller to have the possibility of selling the goods on the buyer's account.

5. Another example of the consequences of the approach adopted is that not only failure to comply with the requirements laid down in the Convention but also cases where a party has not performed his obligations under the contract are treated as breach of contract. Such a rule has far-reaching implications, at any rate formally.

6. However, the Swedish Government considers that the basic structure of the Convention can be accepted.

COMMENTS ON INDIVIDUAL ARTICLES

7. In the Government's opinion, the solutions contained in the individual articles can, generally speaking, be accepted. Certain improvements could, however, be made in respect of specific details. The Government therefore wishes to make the following comments, which are not to be regarded as exhaustive or definitive.

Article 1

8. To enable as many States as possible to accede to the Convention, reservations should be permitted in certain respects. At the present time, Sweden, Denmark and Norway have similar acts relating to the sale of goods. In such circumstances, it should be possible to apply, between different States, common national legal rules that differ from the Convention. Accordingly, when implementing the Convention, a group of States should be able to reserve the right to consider themselves as one State (cf. ULIS, article II). It should also be possible for a State bound by ULIS to become a party to the new Convention.

Articles 5 and 8

9. Under article 5, the Convention's provisions are non-mandatory and article 8, paragraph (2) contains provisions on the effect of usages and practices. On the other hand, there is no express counterpart to ULIS article 9, paragraph (3), whereby provisions or forms of contract commonly used shall be interpreted according to the meaning usually given to them in the trade concerned. In particular, as regards delivery clauses of the f.o.b. and c.i.f. type it is important that it should be made clear that these should generally be interpreted not on the basis of the Convention but in accordance with usages and practices. A provision to this effect should be inserted in article 8.

Articles 15-17 (64-67)

10. The Convention contains separate rules on the delivery and the passing of risk. These rules in part correspond to each other. However, it is difficult to see why different conditions have been laid down. It should be possible to co-ordinate the rules further.

Article 26

11. If the seller has not delivered the goods in time and the buyer wishes to claim damages for the delay, he ought to be required to make his claim known within a specified time-limit.

Article 27 (43)

12. In the commentary on article 27, it is stated that the buyer's right to "require performance" also includes a duty for the seller to "cure any defects". In many situations it would seem appropriate that the seller should have such an obligation but this obligation cannot be unlimited. The defect may be of such a nature that it cannot be cured. To cure the defective performance may also place an unreasonable burden on the seller. The seller's obligation should therefore be clarified in the Convention, possibly in connexion with article 27, paragraph (2).

13. If the seller fails to deliver the goods, the buyer can, under article 27, paragraph (1), *inter alia,* require delivery. In the event of the seller failing to deliver, and the buyer being able to satisfy his requirements in some other way without additional costs, express avoidance would seem in many cases not to arise. Should the price then increase, the draft text allows the seller to require delivery or other performance at a much later date. This provision is unsatisfactory. A condition for maintenance of the right to require performance should be that the buyer presents his request within a reasonable time-limit after the last deadline for delivery. When the buyer has not paid the price, the seller should in the same way be obliged to make his request for performance within the same time-limit.

Article 28 (44)

14. If one party requires performance without indicating "an additional period of time of reasonable length", articles 28 and 44 are not applicable. This seems to apply whether no time-limit has been indicated or the period is shorter than provided for in these articles (e.g. "promptly"). This should not, however, mean that the party who requested performance can then immediately avoid the sale. Instead he should, of course, be obliged to accept delivery effected at once or within the period indicated. The difference between the two types of request for performance should be made clear.

Article 29

15. Article 29, paragraph (2) contains a provision giving the seller a right to request the buyer to make known whether he will accept delivery. Such a rule is natural in those cases where the seller has indicated in his request a reasonable time within which he intends to perform. In other cases the buyer would sometimes find it so evident that he does not wish to accept the goods that he does not bother to reply. This rule should be limited to situations of the former type.

Articles 47 and 49

16. Both article 47, paragraph (3) and article 49 contain rules concerning avoidance as a result of an anticipatory breach. While article 49 requires that it is "clear that one of the parties will commit a fundamental breach", a considerably lower risk is required under article 47, paragraph (3). The latter rule goes too far. Article 47 should be limited to "suspending performance" and the conditions for avoidance — apart from the special case dealt with in article 48 — should be those laid down in article 49.

Article 50

17. The Government does not find that the rules of exemption from liability in damages as they now stand are satisfactory, particularly when applied to defects in the goods, and should prefer to have them reconsidered as concerns both the content and the drafting. Furthermore, it would also seem desirable to deal with exemption from the obligation to perform. Otherwise, there are several situations in which exemption from liability in damages may become worthless because the other party can force performance. For instance, let us suppose that such a shortage of a certain kind of goods arises that difficulties in procuring the goods entail exemption under article 50, paragraph (1). As long as performance is not excluded, the buyer may through delivery, avoid any damage.

18. In principle such exemption from the duty to perform should apply only during the period when the impediment exists (cf. article 50, para. (3)). If a party still wishes to obtain performance when the impediment ceases, it may under the obligation suggested above be his responsibility to request performance. Should the impediment last for a long time, the Convention should indicate that the obligation to perform ceases entirely.

19. On the other hand, there do not seem to be adequate grounds for including special rules on limitations on the other party's right to avoid the contract (or to require a reduction of the price). In principle, this right should exist regardless of whether the other party can invoke exemption from the obligation to perform or not.

UNION OF SOVIET SOCIALIST REPUBLICS

[*Original: Russian*]

Article 1

1. For greater clarity, the words "For the purposes of paragraph (1) of this article" should be inserted at the beginning of paragraph (2).

Article 2

2. In order to achieve uniformity with similar questions in conventions relating to the international sale of goods, the wording of article 2 (*a*) should be identical to that of article 4 of the Convention on the Limitation Period in the International Sale of Goods, namely: "(*a*) of goods bought for personal, family or household use". Consideration should also be given to the question of the advisability of including in the Convention provisions similar to those in article 5 of the aforementioned Convention on the limitation period. In addition, the word "gas" should be inserted in article 2 (*f*), since the terms of contracts for the sale of gas are *sui generis*.

Article 7

3. Delete article 7, paragraph (2), which is enclosed within square brackets.

Article 10

4. Since article 10, paragraph (2), is worded in such a way that it may create the assumption that prior notice by the other party is required before a declaration of avoidance of the contract is forwarded to him, it would be advisable to reword that paragraph and, at the same time, to provide that the notice should be in writing, for example, by stipulating that "A declaration of avoidance of the contract is effective only if it takes the form of written notice to the other party".

Article 11

5. This article is unacceptable and should be deleted from the draft Convention. The question of the form of the contract should be regulated by the Convention on the formation of contracts, which the Working Group is preparing to draft. If a decision is taken to retain in the Convention a provision on the form of contracts, then it is necessary to stipulate that contracts should be in writing, if national legislation so requires, even if that applies in the case of only one of the parties to the contract. As to the consequences of not complying with the provision that the contract should be in writing, it would be possible to provide either that the contract in such cases should be regarded as void, or that the law of the State whose legislation requires that the contract be in writing should apply.

Article 19

6. Paragraph (1) (*b*) should read: "(*b*) are fit for any particular purpose expressly made known to the seller at the time of the conclusion of the contract".

Article 26

7. If it is implied in paragraph (1) that damages may be claimed in addition to the exercise of the rights provided in articles 27 to 33, and not as an alternative, then the meaning of paragraph (2) is not clear.

Article 28

8. Should this article be understood to mean that the penalty provided for in the contract (for example, for delay in delivery) should also be regarded as a remedy to which the buyer cannot resort during the additional period of time provided for in this article?

Article 32

9. In paragraph (2), after the words "if the failure to make delivery completely", the word "and" should be replaced by "and/or" since a fundamental breach of the contract may occur where only one element is present

(failure to make delivery completely, or failure to make delivery in conformity with the contract); it is not necessary for both to be present.

Article 36

10. This article is not acceptable. The price must be determined or determinable.

Article 40

11. The last part of this article should be changed to read: "without the need for any request or other formality on the part of the seller".

Article 42

12. This article gives rise to the same doubts as article 26.

Article 44

13. This article gives rise to the same doubts as article 28.

Article 50

14. The wording of paragraph (1) should be made more precise, as follows: "(1) If a party has not performed one of his obligations, he is not liable for such non-performance if he proves . . .". Paragraph (3) of this article should be deleted.

Article 56

15. Paragraph (2) should be changed to read: "The provisions of paragraph (1) of this article do not preclude the right to seek other damages also, if the conditions of article 55 are satisfied". The proposed change is prompted by a desire to avoid a direct reference to loss of profit, since, in the first place, it is already referred to in article 55, whereby damages are understood to cover loss of profit, and, secondly, in such a situation it is in fact difficult to imagine the possibility of a loss of profit over and above the difference in prices.

Article 57

16. The remarks made in connexion with article 56, paragraph (2), also apply to article 57, paragraph (3).

MATTERS NOT REGULATED OR ONLY PARTLY REGULATED BY THE CONVENTION

17. Provision should be made in the Convention (for example, in article 13) for the application of the law of the country of the seller to those questions which are not regulated or are only partly regulated by the Convention.

STRUCTURAL IMPROVEMENTS TO THE CONVENTION

18. Consideration should be given to the question of the advisability of making certain structural improvements in the draft Convention, in particular, the possibility of combining the provisions concerning remedies for breach of contract by the seller (chap. III, sect. III) and remedies for breach of contract by the buyer (chap. IV, sect. III).

UNITED STATES OF AMERICA

[Original: English]

1. The United States of America welcomes the draft Convention on the International Sale of Goods, as submitted to UNCITRAL by the Working Group on this subject (A/CN.9/116, annex I).* The proposals set forth in the draft are the product of much thought and study by the Working Group, which is to be commended for the contribution that it has made to the development of the law of international sales transactions. The draft Convention supplies a good basis for elaboration at the proposed diplomatic conference of a definitive text. The United States will be pleased to participate in this enterprise and wishes to submit the following comments on the text for consideration at the conference. These comments are grouped under three headings: major substantive proposals; drafting proposals; support for other proposals.

MAJOR SUBSTANTIVE PROPOSALS

A. *The commentary*

2. The United States is substantially in accord with the commentary on the draft Convention on the International Sale of Goods (A/CN.9/116, annex II).** It believes that, although not part of the text itself, the commentary is vital to the acceptability of the draft Convention for three reasons.

3. First, there are some instances in which the commentary is necessary to assist those who are not familiar with the text in understanding its meaning. This is particularly true in view of article 13, which speaks of "the need to promote uniformity" in "interpretation and application" of the provisions of the Convention. An example is article 31, which provides that the buyer may declare a reduction in price of non-conforming goods. This remedy is unknown in common law countries and would not be understood by lawyers in those countries without the helpful comments. Comment 3 is of particular importance, since without it such a lawyer might not suppose that the remedy was available to the buyer even though he had already paid the price. A different type of example is afforded by article 28, which allows the buyer to request performance within an additional period of time, but leaves it to comment 3 to tell the reader that, if the seller does not comply, the buyer has the remedy of avoidance of article 30(1)(*b*). A similar point can be made as to articles 30 and 45, which provide for avoidance but leave it to comment 3, in each case, to tell the reader of the notice requirement in article 10 for avoidance. The number of examples, where the comments perform such a vital function, is very large.

4. Second, the commentary will be extremely useful during the period when legal and business circles are considering whether to recommend ratification by their governments. Our advisers from business and the private practice of law are unanimous about the desirability of

* Yearbook . . ., 1976, part two, I, 2.
** *Ibid.*, part two, I, 3.

maintaining the commentary and would, indeed, have difficulty in comprehending the text without it.

5. Third, the commentary will be useful after the text becomes effective in promoting uniformity. Making this valuable aid to interpretation readily available to all will help to achieve the aims of article 13. Background material on the text, including earlier drafts and the present commentary, as well as texts that may be written in the future, will be available to lawyers who are in major commercial centres with substantial law libraries. Less centrally located lawyers will be disadvantaged by their situation unless there is a commentary that accompanies the final text. The comments to our Uniform Commercial Code were designed to serve somewhat this purpose and, although they do not form part of the law that enacts the text they have been well received and are highly regarded. Accordingly, the United States urges that the commentary be submitted to the General Assembly together with the draft articles and recommends that the text adopted by a diplomatic conference should be accompanied by a commentary.

6. Further, the United States proposes that the commentary be expanded by the addition of titles for the discussion of each article in the commentary. These titles could be placed before the text in brackets to indicate that they do not form part of the text of the articles and would appear only in editions containing the commentary.

7. Should a commentary not accompany the text when it leaves the Commission, the United States would find it necessary to propose a considerable number of drafting changes for the text, to make it more detailed and to add cross references which would point the reader to other provisions that qualify or supplement the provisions in question.

B. *Notices and other communications (article 10)*

8. Article 10(3) deals with transmission hazards for only two kinds of communications: (1) declarations of avoidance, and (2) notices of non-conformity required by article 23. Since national rules on transmission hazards are far from uniform, it is important that the text state a clear rule. The draft provides for communications in many other articles: article 16(1) ("send the buyer a notice"), article 16(3) ("at his request"), article 29(2) ("requests the buyer"), article 31 ("declare the price to be reduced"), article 45(1)(b) ("has been requested . . . has declared"), article 46(1) ("specify . . . after receipt of a request"), article 46(2) ("inform the buyer"), article 47(3) ("give notice to the other party . . . received the notice"), article 50(4) ("must notify"), article 63(1) ("notice . . . has been given"), article 63(2) ("give notice"). The situation under the draft is perhaps more complex than if no rules for transmission hazards had been included. In cases not covered by article 10(3), one might expect three competing contentions: (1) non-uniform solutions should be sought in national laws; (2) the rule of article 10(3) should be extended by analogy; (3) a rule opposite to that of article 10(3) should be applied.

9. Furthermore, article 10(1), which says that notices "must be made" by appropriate means, appears to be either unjust or misleading. This might be read to mean that the sanction for non-compliance is that the notice will be denied effect. But this would be unjust if the notice was actually received in time although not by an approved "means". The sentence ought to mean that the sender is deprived of the benefit of a rule like that in article 10(3), relieving him of the risk of transmission hazards.

10. The United States therefore proposes the following revision:

Article 10

"[1. Notices provided for by this Convention must be made by the means appropriate in the circumstances.]

"[2.] 1. A declaration of avoidance of the contract is effective only if notice is given to the other party.

"[3.] 2. If [notice of avoidance or any notice required by article 23] *any other notice, request or communication provided for by this Convention* is sent by [appropriate means] *means appropriate in the circumstances* within the required time, the fact that the notice fails to arrive or fails to arrive within such time or that its contents have been inaccurately transmitted does not deprive the sender of the right to rely on the notice."

C. *No writing required (article 11)*

11. Article 11 has been placed in brackets because agreement could not be reached on it. The difficulty came in reconciling it with national rules requiring a writing for sales contracts executed by, for example, a State trading organization or other company. The United States assumes that the problem is one of restrictions on the authority of representatives of a State trading organization or company validly to contract other than in a prescribed form. The United States, therefore, proposes the following additional paragraph:

Article 11

"1. A contract of sale need not be evidenced by writing and is not subject to other requirements as to form. It may be proved by means of witnesses.

"2. *The provisions of paragraph (1) do not affect an otherwise valid restriction on the authority of a party to conclude a contract other than in a prescribed form or manner if that restriction is prescribed by statutory law of the State where the party has its place of business and is either known to the other party or is widely known and regularly observed by parties to contracts of the type involved.*"

D. *Action for price (article 43)*

12. Article 43 provides that, unless the seller has resorted to an inconsistent remedy, he "may require the buyer to pay the price". This appears to allow the seller to recover the price in a suit against the buyer, even though buyer has repudiated when the goods are still in the hands of a seller who has an available market on which he can sell them. It would appear that a seller who had not yet begun to manufacture goods could take advantage of this provision. Not only would this rule work an abrupt and regressive change in American law but it is inconsistent with sound commercial practice. A seller who can mitigate his loss by selling on the

market should be expected to do so, consistent with the policy behind article 59 on mitigation of damages. The United States therefore proposes that article 43 be modified:

Article 43

"The seller may require the buyer to pay the price, take delivery or perform any of his other obligations, unless the seller has resorted to a remedy which is inconsistent with such requirement *or in the circumstances the seller should reasonably mitigate the loss resulting from the breach by reselling the goods.*"

13. An alternative solution would be to modify article 59:

Article 59

"The party who relies on a breach of contract must adopt such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to adopt such measures, the party in breach may claim a reduction in the damages, *including any claim for the price*, in the amount which should have been mitigated."

14. If such a change is not made, it would be desirable to limit the action for the price to cases in which the buyer has accepted the goods or the goods have been destroyed or damaged after the risk has passed.

E. *Partial avoidance by seller (articles 32 and 48)*

15. The draft attempts to provide comparable rights for sellers and buyers. There appears to be an oversight in this regard as to partial avoidance of the contract by the seller. When the contract provides for delivery in instalments and one party's performance (seller's delivery or buyer's payment) is seriously deficient with respect to one instalment, the other should be permitted to refuse his counter performance (buyer's payment or seller's delivery) as to that instalment. It would be wasteful to force a party to cancel the whole contract unless the breach as to past instalments threatens "a fundamental breach as to future instalments". Article 32 deals with this situation where the seller is in breach, but there is no comparable provision for the situation where the buyer is in breach. The United States proposes that a new paragraph (1) be added to article 48: (Present paragraphs (1) and (2) would be renumbered (2) and (3)).

Article 48(1)

"1. *In the case of a contract for delivery of goods by instalments, if the failure of one party to perform any of his obligations in respect of any instalment constitutes a fundamental breach with respect to that instalment, the other party may declare the contract avoided with respect to that instalment.*"

16. In addition, the caption to section I of chapter V should be expanded to read:

Section I. Anticipatory breach; instalment contracts

F. *Impracticability (article 50)*

17. Article 50 gives the appearance of being the result of compromise. The result is generally satisfactory, but does not sufficiently distinguish between the case of the destruction of specific goods which the parties assume will be in existence (see example 50A in the commentary) and the destruction of goods that the seller planned to use to fulfil the contract (see example 50B in the commentary). (The explanation of example 50B in the commentary is inadequate since no language in the text supports it.) The deficiency can be remedied if a requirement is added that the non-occurrence of the impediment must have been an implied condition of the parties of the contract. The United States proposes the following revision of article 50(1), which also contains some drafting suggestions in the second sentence:

Article 50(1)

"1. If a party has not performed one of his obligations, he is not liable in damages for such non-performance if he proves that it was due to an impediment which has occurred without fault on his part *and whose non-occurrence was an implied condition of the contract.* For this purpose there is deemed to be fault unless the non-performing party proves that he could not reasonably have been expected to [take] *have taken the impediment into* account *at the time of the conclusion* of the *contract* or to [avoid] *have avoided* or [to] overcome [the impediment] *it after it occurred.*"

G. *Risk in documentary sales (article 65)*

18. The present version of article 65(1) provides that where the contract involves carriage, risk passes to the buyer when the goods are handed over to the first carrier unless the seller is "required to hand them over at a particular destination". This may be adequate to deal with contracts that are clearly "destination" contracts (e.g., f.o.b. buyer's city), but its application to c.i.f. contracts (e.g., c.i.f. buyer's city) is unclear. It may be that no negative implication is intended and that article 65(1) does not apply to either of the types of contracts just mentioned. Or it may be that c.i.f. contracts are governed by article 65 on the ground that the "insurance" term amounts to a degradation from the negative implication of article 65(1) so that risk passes on delivery to the first carrier. (This would not explain why the same result follows under a/c.&f. contract.) Furthermore, it would be desirable to modify article 65 to make it clear that the seller's retention of control through taking a bill of lading does not derogate from the usual rules. If the substance of article 65(1) is to remain the same, it would be desirable to modify article 65(1) as follows:

Article 65(1)

"1. If the contract of sale involves carriage of goods and the seller is not required to hand [them] *the goods* over *to the buyer* at a particular destination, the risk passes to the buyer when the goods are handed over to a carrier for transmission to the buyer. *The fact that the seller is authorized to retain documents controlling the disposition of the goods does not affect the passage of risk.*"

DRAFTING PROPOSALS

A. *Consistent terminology*

19. As the delegation of the United States pointed out at the seventh session of the Working Group, the draft uses a wide variety of terms such as "have reason to know" (articles 2(*a*), 8(2)), "ought to know" (articles 22(3), 30(2)(*b*), 45(2)(*b*), 50(4), 55, 65(2); cf. article 23(1)), "could not have been unaware of" (articles 19(2), 24), "foresee" (article 9), and "contemplate" (articles 6(*a*), 48(2)). The over-all effect to a lawyer familiar with the drafting of legislation in the United States is that of a carelessly drafted text. Although different shades of meaning may be conveyed by some of the terms listed, the terms "foresee" and "contemplate" are synonymous in our legal usage and "foresee" is in wider current use. The terms "have reason to know" and "ought to know" are also synonymous in our legal usage, and although "have reason to know" is in wider current use, its consistent use in the draft would require a larger number of changes than would consistent use of "ought to know". The United States proposes, therefore, the following changes:

Article 2(a): ". . . unless the seller, at the time of the conclusion of the contract, [did not know and had no reason to know] *neither knew nor ought to have known that the goods were bought for any such use;* . . ."

Article 6(a): ". . . having regard to circumstances known to or [contemplated] *foreseen* by the parties at the time of the conclusion of the contract."

Article 8(2): ". . . a usage of which the parties know or [had reason to know] *ought to have known* . . ."

Article 48(2): ". . . for the purpose [contemplated] known to or foreseen by the parties . . ."

B. *Conformity of style in articles 15 and 41*

20. Article 15, on the seller's obligation to deliver, and article 41, on the buyer's correlative obligation to take delivery, follow different drafting styles. The United States proposes that the articles be brought into harmony by making the following changes in article 15. (This would also avoid the implication that article 15 *defines* the act of delivery. For example, even though the seller fulfils his *obligation* to deliver by "placing the goods at the buyer's disposal" at a particular place such as the seller's place of business (see end of paragraph (b)), there has been no physical *delivery* because the goods have not been handed over to or taken over by the buyer. Indeed, in most cases where the buyer fails to come for the goods, the seller will resell them and there will never be delivery to the buyer in breach.)

Article 15

"If the seller is not required to deliver the goods at a particular place, [delivery is made] *the seller's obligation to deliver consists:*

"(*a*) If the contract of sale involves carriage of the goods, [by] *in* handing the goods over to the first carrier for transmission to the buyer,

"(*b*) If, in cases not within the preceding paragraph, the contract relates to

(i) Specific goods, or

(ii) Unidentified goods to be drawn from a specific stock or to be manufactured or produced, and at the time of the conclusion of the contract the parties knew that the goods were at, or were to be manufactured or produced at, a particular place, [by] *in* placing the goods at the buyer's disposal at that place;

"(c) In other cases [by] *in* placing the goods at the buyer's disposal at the place where the seller had his place of business at the time of the conclusion of the contract."

C. *Location of article 25*

21. The section that deals with conformity of the goods begins with article 19, which states the seller's obligation as to defects of quality, and ends with article 25, which states the seller's obligation as to defects of title. The five intervening sections contain rules that qualify article 19, but their applicability to article 25 is unclear because of its location. The United States believes that, to the extent that the context permits, the rules in those five sections are as applicable to the obligations imposed by article 25 as they are to those imposed by article 19. It therefore proposes that article 25 be moved either to precede or follow article 19, with appropriate renumbering.

D. *Scope of right of avoidance under article 45(1)(b)*

22. In international sales the critical step in buyer's performance is often not the buyer's actual *payment* of the price, but the *establishment* of "a letter of credit or a banker's guarantee" (article 35). Article 44 provides that, on default by the buyer, seller "may request *performance* within an additional period of time of reasonable length". The words "request performance" are sufficiently broad to embrace a request for establishment of a letter of credit or banker's guarantee required by the contract. However, article 45(1)(*b*), in implementing article 44, provides merely for avoidance by the seller if the buyer, after a request, has failed "to *pay* the price or take delivery". This failure "to pay" would not include a failure to take the steps mentioned here. (The use of "pay" in article 34 and "steps to enable the price to be paid" in article 35 suggests that the word "pay" does not encompass such steps.) The United States, therefore, proposes that article 45(1)(*b*) be revised:

Article 45(1)(b)

"1. The seller may declare the contract avoided:

". . .

"(*b*) If the buyer has been requested under Article 44 to pay the price, *or to take the necessary steps with respect to payment required under Article 35*, or to take delivery of the goods, and has not [paid the price or taken delivery] *complied with the request* within the additional period of time fixed by the seller in accordance with [that] Article 44 or has declared that he will not comply with the request."

E. *Technical suggestions*

23. The United States proposes the following changes which are, it believes, largely self-explanatory:

(*a*) *Article 15*: The words "and at the time . . . at that place;" should be indented to indicate that they are part of paragraph (*b*) and do not modify paragraph (a);

(*b*) *Article 16*: In paragraph (3), the phrase "*the*

seller must provide" should be changed to "*he* must provide", to conform to the style of paragraph (2) ("*he* must make"). (In paragraph (1) the phrase "*the seller* must send" is justified because the word "carrier" intervenes between the first use of "the seller" and this phrase).

(*c*) *Article 19(1)*: The words "Except where otherwise agreed" should be deleted as unnecessary in view of Article 5 and as suggesting, by negative implication, that other rules relating to conformity are not subject to derogation or variation by the parties.

(*d*) *Articles 19, 31*: The words "conform *with*" should be changed to "conform *to*" in order to conform to correct English usage.

(*e*) *Article 29*: The words "perform" and "performance", which appear a total of four times in paragraphs (2) and (3), should be replaced by "cure". This will make the reference to paragraph (1) clearer.

(*f*) *Article 36*: The phrase "*generally* prevailing at *the aforesaid* time" should be changed to "prevailing at *that* time" to make it consistent with article 57, which does not use "generally" to modify "prevailing" and to avoid "aforesaid", a stilted word.

(*g*) *Article 39(2)*: The words "at the place of destination" should be deleted.

(*h*) *Article 47(1)*: The word "capacity" should be replaced by "ability" (or perhaps "capability") because the word "capacity" is often used to refer to legal capacity, including questions of insanity and even authority to represent a principal.

(*i*) *Article 48(2)*: The word "*entering* the contract" are ungrammatical and inconsistent with the style of other articles (e.g., article 6(*a*)). They should be changed to "*at the time of the conclusion* of the contract".

(*j*) *Article 63(1)*: The syntax is garbled. The paragraph should be revised to read:

> 1. If there has been an unreasonable delay by the other party in taking possession of the goods or in taking them back or in paying the cost of preservation [and notice of his intention to sell has been given], the party who is under an obligation to preserve the goods in accordance with articles 60 or 61 may sell them by an appropriate means, *after giving notice to the other party of his intention to sell.*

SUPPORT FOR OTHER PROPOSALS

A. *United Kingdom proposal for article 50(3)*[1]

24. The United States supports the proposal of the United Kingdom to add a sentence to article 50(3). That paragraph, with a few stylistic changes in the United Kingdom proposal, would read:

Article 50(3)

> "3. The provisions of paragraph (1) and (2) are applicable only for the period during which the impediment existed. *However, the non-performing party shall be permanently relieved of his obligation if, when the impediment is removed, the performance has so changed that the contract has become materially more burdensome than had the impediment not occurred.*"

B. *Norwegian proposal for article 66(3)*[2]

25. The United States supports the proposal by Norway to add a new paragraph (3) to article 66, which with a change of style would read:

> "3. *If the goods are not identified for delivery to the buyer, by marking with an address or otherwise, they are not clearly identified to the contract, unless the seller gives notice of the consignment and, if necessary, sends some documents specifying the goods.*"

YUGOSLAVIA

[*Original: English*]

GENERAL OBSERVATIONS

1. Yugoslavia attaches exceptional importance to the passage of the Convention on the International Sale of Goods and in keeping with this it has been following the work of the United Nations Commission on International Trade Law (UNCITRAL) on the drawing up of a new text elaborated in the form of the first draft by the Working Group of the Commission. No doubt the task of the Working Group was much harder than the work performed formerly by the International Institute for the Unification of Private Law (UNIDROIT) since, in addition to the existing system of the common law and the systems based on civil law, it was requisite to take into consideration this time the interests of the developed and the developing countries, as well as the systems based on planned economy and the ones characterized by free trade. It is quite understandable that it was neither easy nor simple to harmonize all these interests. This is also where there might have ensued some short-comings in the text, which will be indicated hereafter.

2. Yugoslavia deems it appropriate that UNCITRAL should have taken the initiative to revise the 1964 Hague Uniform Law. This is primarily due to the fact that many developing countries, who need such a document even more than the developed countries, did not have the opportunity to participate in the drawing up of the text.

3. Yugoslavia is of the opinion that the present text should be viewed also as proceeding from the idea of establishing a new economic order stemming from the decisions of the sixth and seventh special sessions of the General Assembly of the United Nations. It is the general impression that the work of UNCITRAL on the adoption of documents which would regulate the relations between the buyer and seller in the context of the conclusion of contracts on international sale of goods is in line with the general aspirations of the developing countries that international trade and its regulation be considered also from the standpoint of the requirements of the developing countries, which so far have not been, or at least not sufficiently, taken care of. It is well known that contracts on international sale of goods are concluded with reference to standard contracts and general conditions, which contain a whole set of clauses suited to

[1] Proposed by the United Kingdom during the seventh session of the Working Group on the International Sale of Goods (5-16 January 1976). [Foot-note inserted by the Secretariat.]

[2] Proposed by Norway during the seventh session of the Working Group on the International Sale of Goods (5-16 January 1976). [Foot-note inserted by the Secretariat.]

the economically more powerful contracting parties. With the adoption of the Convention on the International Sale of Goods some of these weaknesses might be eliminated. Some of the provisions of the Convention in this respect should perhaps be imperative in character.

4. On the other hand, due to the work of UNCITRAL on the revision of the Hague Uniform Law, many countries, among them Yugoslavia, have postponed the taking of any measures with a view to ratifying the Convention on the 1964 Uniform Law, until the emergence of the new text, so that the final adoption of the Convention on International Sale of Goods will put an end to the present state of expectation and incertitude. All the more so because in respect of the definition of the notion of international trade there are three texts at the moment (the Hague Uniform Law, the Convention on the Limitation Period in the International Sale of Goods and the draft Convention on the International Sale of Goods), which has also been a source of doubt and uncertainty. Therefore, it would be indispensable to concentrate all efforts into making this last stage in the passage of the Convention as short as possible.

5. The adoption of the Convention on the International Sale of Goods is indispensable also because it is going to create possibilities to start — proceeding from this, so to say, "basic text" — the drafting of other numerous regulations so badly needed in the field of international sale, particularly by the developing countries.

6. The authority of the United Nations standing behind the present Convention will undoubtedly contribute to its prestige, hence it is right to expect that convention, especially if some improvements in the text are made, to fare better than the previous similar texts, i.e. to be ratified by a larger number of countries.

7. In order to achieve all this it is necessary at this final stage to approach the work with maximum seriousness and goodwill, with no desire to insist on solutions which suit only some particular States, but with the awareness that it is an international text, which should correspond to the interests of the greatest possible number of States. Yugoslavia is of the opinion that it is important to bear in mind the following:

(*a*) The Convention has to reflect the spirit and the aspirations of the new international economic order;

(*b*) The Convention has to protect fairly and equally the interests of both the buyer and the seller.

8. On the basis of the two above-mentioned criteria, one gets the impression that some weaknesses of the former Hague Uniform Law on the International Sale of Goods have been avoided in the draft. In this respect the following could be pointed out as positive:

(*a*) The fact that the breach of the contract "by authority of law" has been abolished, since the institution of an automatic breach can operate only in highly developed economic systems. The breach of a contract "by authority of law" could have serious and harmful consequences to the developing countries;

(*b*) The fact that, at a number of places in the text of the draft "short time" has been replaced by "reasonable time".

9. On the other hand, with regard to the above-mentioned criteria, but also independently from them, the following observations could be made in connexion with the draft Convention on the International Sale of Goods:

OBSERVATIONS ON PARTICULAR ARTICLES

Usages (article 8)

10. Under article 8, paragraph 2 of the draft Convention "the parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract a usage of which the parties knew or had reason to know and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned". With regard to the similar provision contained in article 9 of the Hague Uniform Law, the second sentence in paragraph 2 of this article on the prevalence of usages over the Uniform Law in case of disagreement has been eliminated, which is good. However, the question is whether the draft does not lend too much strength to usages, which might create a possibility that, by referring to the Convention, those usages be applied which, as is well known, were created by the economically strong groups having positions of power on the world market.

11. It is indispensable therefore to give another meticulous thought to the significance and impact of the provisions contained in paragraph 2 of article 8 of the draft. Formulated like this, this paragraph means that usages will be most frequently applied, thus derogating from the provisions of the Convention.

12. Paragraph 3 of article 9 of the Hague Uniform Law dealing with the interpretation of expressions, provisions or forms used in trade has been omitted. This paragraph seems to have been useful, so its inclusion in the Convention is proposed to be reconsidered.

Fundamental breach of the contract

(article 9)

13. Article 9 of the draft Convention regulates the question of the fundamental breach of the contract proceeding from an objective criterion, i.e. the substantial detriment, and from the subjective one, i.e. that the party "in breach foresaw or had reason to foresee such a result". The question is what is the meaning of the "substantial detriment" and how will it be determined. On the other hand, it seems that the simplicity and easy comprehension of the proposed definition have in a way narrowed the scope of former article 10 of the Hague Uniform Law (which was criticized also by the Yugoslav experts, as being complicated, hard to comprehend and difficult to apply in practice). Namely, comparing these two texts one gets the impression that the definition contained in article 10 of the Hague Uniform Law covers a larger number of situations.

Sanctions in the case of breach of the contract

(articles 26-33 and 42-46)

14. The provisions dealing with sanctions in the case of breach of the contract are concise and simplified, which could be observed as harmful to their systematization and clarity. While the Hague Uniform Law had especially elaborated sanctions in the case of failure to

perform obligations with regard to the place and date of delivery (articles 24-29) and, in particular, with regard to the lack of conformity (articles 41-49), all these sanctions have been concentrated and concisely formulated in the draft Convention, whereby, it is true, the number of articles has been reduced, but on the other hand, reference is frequently made in the text to other articles of the Convention, which is a burden especially to businessmen, for whom such an approach is inconvenient.

The conformity with the contract

(articles 27 and 28)

15. If the goods do not conform with the contract, the buyer may, under the draft Convention, require the performance of the contract (articles 27-28). The missing part here is, what actually is performance of the contract and though in some articles of the draft (e.g. in articles 21 and 29) the cure was mentioned, this question was more adequately regulated in the Hague Uniform Law. In view of the importance of the cure or remedy (particularly when the delivery of machinery, equipment, etc. is involved), as a result of recent times, it would be advisable to include the provision of article 42 of the Hague Uniform Law at the appropriate place in the draft Convention.

The form of the contract

(article 11)

16. Dealing in international sale of goods should be, in principle, informal. Therefore, the present formulation in article 11 of the draft Convention is satisfactory. The second part of the sentence relating to proof by means of witnesses might as well be eliminated on the grounds of its being unreliable, i.e. the fundamental proofs for the sale of goods being the written documents.

ZAIRE

[*Original: French*]

GENERAL OBSERVATIONS

1. A draft Convention on the International Sale of Goods was prepared by the Working Group of the United Nations Commission on International Trade Law in Geneva from 5 to 16 January 1976.

2. The draft consists of 67 articles, which are designed:

To discourage parties from seeking the jurisdiction in which the law is the most favourable;

To reduce the need for recourse to the rules of private international law;

To provide a modern law of sale which will be suitable for international transactions.

3. In general, it appears after analysis of the provisions of the draft that the latter is supplementary and non-binding in character, and the Executive Council of the Republic of Zaire endorses the provisions of article 5, which gives States the option of not applying any given provision because of differences in the legal systems of States.

4. However, the draft Convention says nothing about the multiplicity of customs régimes, which are complex.

5. In that connexion, the Working Group should have included a provision governing the customs régimes of different States and especially those of frontier cities.

6. The foreign trade regulations of the People's Republic of the Congo (see Belgian Foreign Trade Office publication No. 221-1965) provide for a 20 per cent municipal tax on goods imported through the port of Brazzaville, which presupposes exportation through the city of Kinshasa in the Republic of Zaire.

7. This régime affects only the two cities and cannot arise elsewhere.

8. For that reason, the Executive Council wishes the Commission to take account of this international problem.

9. Furthermore, the Executive Council feels that, when the draft Convention is adopted, the Commission should be able to make certain articles more explicit, as set forth in detail in the commentaries on them in annex II of the draft.

OBSERVATIONS ON PARTICULAR ARTICLES

10. In article 10, paragraph 1, the "means appropriate in the circumstances" should be specified.

11. There are various means of communication just as there are various sets of conceivable circumstances, and one therefore wonders whether parties are to be free to employ any means of communications they wish.

12. Similarly, the draft Convention should specify in article 11 which witnesses may prove a contract, since the question arises whether witnesses might not be from States not parties to the contract.

II. Comments by international organizations

INTERNATIONAL CHAMBER OF COMMERCE

[*Original: English*]

GENERAL OBSERVATIONS

1. The ICC welcomed the 1964 Hague Convention relating to a Uniform Law on the International Sale of Goods (ULIS) and has by various means encouraged ratification thereof. Although now a number of ratifications have followed, a still greater number of States have found obstacles to adhering to this Convention in its present shape. The work undertaken by UNCITRAL and its Working Group to revise the text of ULIS 1964 or, more properly expressed, to elaborate a new text of a convention on the subject-matter based upon ULIS 1964 in order to make a uniform law more acceptable to a greater number of States, is likewise welcomed by the ICC and seen as a most important contribution to the work on uniformization of the law on sales. The ICC believes that as a whole the present text represents a substantial progress in the field and that the draftsmen seem to have managed to remove a number of the difficulties which have made many States reluctant to ratify the Hague Convention (ULIS 1964). The ICC hopes therefore that the revised text will attract a greater number of ratifying States than ULIS 1964 and that ratifications will follow without much delay.

2. At the same time, however, the ICC wants to stress the importance of the fact that already a number of States have ratified ULIS 1964 and that therefore the present efforts of unification must take into consideration the fact that the new text ought not, without compelling reasons, to differ from ULIS 1964. It is also important that in the elaboration of the transitional provisions, due consideration be given to the situation of States which have already ratified ULIS 1964 and the difficulties for these States of replacing the earlier Convention by the new one.

3. The new text is presented in the form of a convention and not, as was ULIS 1964, as a uniform law. The ICC regrets this change, as the ultimate goal of uniformity is more definitely achieved with a uniform law applying itself to sellers and buyers instead of a convention applying to contracting States.

OBSERVATIONS ON PARTICULAR ARTICLES

Article 14

4. The Convention provides no "definition" of "international sale". Instead it defines its sphere of application. This has become somewhat wider than that of ULIS 1964; one simplification is that the Convention applies when parties have their place of business in different contracting States. Such extension does not however seem objectionable, nor does the exclusion of consumer sales, as such exception may make the Convention acceptable to a greater number of States.

5. The Convention further applies when the rules of private international law lead to the application of the law of a contracting State. This provision combined with the previous one, to the effect that the Convention applies only when the parties to the sale are from different contracting States, represents a useful compromise instead of the provision in article 2 ULIS 1964 which excluded the rules of private international law for the purpose of application of the uniform law and which, instead of leading to uniformity, resulted in a complicated system of reservations and which in some circles made the uniform law unacceptable.

Article 6

6. The ICC observed, in relation to the provisions on place of business in the Convention on Prescription in the International Sale of Goods, that these provisions could be improved. The ICC repeats this observation in relation to the similar provisions in article 6. No indication is given in the text as to what should qualify as a "place of business". It is most important that not every place that qualifies as "a permanent establishment" in the meaning of numerous double taxation agreements — e.g. the presence of an agent with power to conclude a sale — be understood as a place of business in the meaning of the Convention. To qualify as a place of business for the purpose of an international sale and the application of the Convention, a permanent business organization including localities and employees for the purpose of the manufacture or sale of goods or services should be maintained. Such place of business, usually called a "branch", should not be confused with subsidiaries or a daughter company which are distinct legal entities.

7. Furthermore the criterion of "closest relationship" could lead to undesirable uncertainties and confusion with the private international law doctrine of closest relationship and must therefore be avoided. Only if the contract was concluded in the name of such branch should such place of business be relevant for the application of the Convention.

Article 7

[See paragraph 26 of these comments.]

Article 8

8. The ICC finds it very important that the Convention expressly states the role which usages play in the determination of the legal relations between buyer and seller. Usages are as important for doing justice to the buyer as to the seller and quite independently whether a party has its place of business in an industrialized country or in a developing country. The essence of any rule giving relevance to usage is that the newcomer in the trade should not be able to plead his ignorance of the usages as a defence. For that purpose sometimes also local usages must be taken into consideration, e.g. usages of a certain port from which the goods are going to be shipped. It is therefore regrettable that the provisions in paragraphs 1 and 2 of article 8 which state the relevance of truly international usages do not also deal with local usages. As paragraphs 1 and 2 represent a compromise which it has been difficult to reach, the ICC nevertheless finds the present text acceptable. The ICC thereby notes that, as it understands it, even with the present text so-called local usages are also, in some situations, to be taken into consideration, e.g. in the case where they are internationally known.

9. The ICC regrets, however, that the paragraph dealing with the interpretation of trade terms has been deleted from the present text. Problems relating to the interpretation of trade terms are not necessarily the same as those connected with the relevance of usages. In any case it should be made clear that the interpretation of a trade term, like FOB or CIF, should not be made with the help of the provisions in the Convention or a definition in any national law indicated by private international law rules, but with reference primarily to international standards of interpretation. The ICC would therefore favour the reintroduction of the provision in article 9, paragraph 3, of ULIS 1964.

10. The ICC notes that some representatives in the Working Group, who have found it difficult to adopt this text have, instead, proposed the following text (A/CN.9/52, para. 82):*

> "Where expressions, provisions or forms of contract commonly used in commercial practice are employed, the meaning usually given to them in the trade concerned shall be used in their interpretation in accordance with the provisions of paragraphs 1 and 2."

11. The ICC prefers such text to none at all. Thereby two things should at least be avoided: that trade terms be interpreted with the help of the Convention (e.g. its rules on passing of the risk), and that local or national standards of interpretation take precedence over international.

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* Yearbook . . . , 1971, part two, I, A, 2.

Article 9

12. Although the vagueness of the present definition of "fundamental breach" may be regretted, the present definition represents a considerable improvement compared to the definition in ULIS which, as based on a hypothetical situation, is too artificial and difficult to apply.

Article 11

13. The ICC has repeatedly stressed the importance of the provisions in article 15 of ULIS 1964 and the need for such provisions to find their place in the Convention. To expose world trade to the requirements of written form could really create difficulties for such trade and result in injustices to parties involved therein, particularly if applied to later modifications of an earlier agreement. Also as concerns the conclusion of the initial agreement a considerable part of world trade relies upon arrangements other than written contracts.

14. The deletion of such provision would lead to application of conflict of law rules, which would reintroduce some of the uncertainties that a uniform law or a convention should seek to eliminate.

Article 13

15. The redrafting of article 17 of ULIS 1964 now to be found in article 13 of the Convention represents an improvement and is therefore welcomed.

Article 14

16. The deletion of "conformity" as a prerequisite for "delivery" has met with general approval in circles consulted and is therefore to be welcomed by the ICC. The suppression of the distinction between non-delivery (late delivery) and delivery to the wrong place is also an improvement.

Articles 15 and 17

17. The text no longer attempts to establish a general definition of "delivery" — which would be very difficult — but gives definition for a few more important cases, a general approach to which the ICC will not object.

18. As a rule, delivery and the passing of the risk are connected to each other. To make separate sets of rules for delivery and for the passing of the risk is not advisable and would easily result in confusion, if the two sets of rules did not follow each other closely. In article 15, however, the rule in (*b*) and (*c*) is that delivery is effected when the goods are *placed at the buyer's disposal*. "Delivery" here seems to mean that the seller has performed. However, according to the rule proposed in article 66, paragraph (1), "the risk" does not pass to the buyer until the goods have been *taken over* by him. This seems to imply that the seller has to deliver substitute goods in place of those which were lost and also, that his responsibility for buyer's damages could be engaged. Admittedly, an exception is provided in article 66, paragraph (2) for the case where the buyer's failure to take over the goods constitutes a breach of contract.

19. The problem seems therefore to be of significance in the case where a "delivery period" has been agreed upon, e.g. "delivery June 1975". According to article 17, the seller *in dubio* has the option of fixing the exact date of delivery. If the buyer's failure to take over the goods on a day so fixed by the seller constitutes a breach of contract, the question will be resolved with the help of the said provision in article 66, paragraph (2).

20. Sometimes, however, a delivery period must be understood to mean that the buyer commits no breach of contract unless the delivery period has expired without his having taken over the goods. Such a situation would be similar to that when the goods are sold "ex works". According to the definition in INCOTERMS, which reflects commercial practice, the risk passes to the buyer when the goods have been placed at his disposal. It is therefore believed that the same rule should prevail in article 66, paragraph (1) of the Convention and that this provision should be reconsidered accordingly.

21. The ICC understands from the discussion in the Working Group that, when a given particular delivery term such as "ex works", "FOB" or "CIF" has been agreed upon, the interpretation thereof shall be made by the help of usages referred to in article 8 and not with reference to the rules in articles 15, 65 and 66. To avoid any misunderstandings in this respect, it should be expressly so stated in the text and the said articles amended accordingly.

22. Article 17 (*b*) and (*c*) which gives the seller the choice of determining the date of delivery should be amended by a provision that the seller has to give the buyer notice of the seller's choice.

23. Already at the Hague Conference in 1964 the ICC expressed the view that the buyer should, if he wanted to claim damages because of late delivery, give notice thereof to the seller promptly (or at least within reasonable time) after actual delivery. This view is still held by a majority within circles consulted by the ICC and the ICC therefore has found no reason to change its position in this respect.

Article 19

24. Article 19 stipulates, *i.a.*, in paragraph 1 (*b*), that the goods shall be fit for any particular purpose "expressly or impliedly made known" to the seller at the time of contracting. If this expression is to be understood in the sense that the responsibility of the seller is engaged only when such particular purpose has been *made clear* to him, the ICC has no objection to it; otherwise it would be advisable to clarify the text in such direction.

25. The ICC has with special interest observed questions concerning the seller's responsibility for ensuring that the goods comply with administrative regulations or that the goods do not infringe industrial property rights, which have special aspects in international trade. The seller cannot, as a general rule, take such responsibility as to administrative regulations or industrial property rights in the country of the buyer. This view seems, to the satisfaction of the ICC, to be reflected in the text of article 19 as such non-compliance or infringement might be considered not to touch upon the fitness of the goods for purposes for which they would be *ordinarily* used, and the question whether they would be fit for the *particular* purpose of being used in the buyer's country would

have to be answered with the application of subparagraph (*b*) of this paragraph, which exempts from liability when it was not reasonable for the buyer to rely upon the seller's skill or judgement.

26. However, at its seventh meeting the Working Group introduced an amendment to article 7, saying that the Convention does not govern the rights and obligations between the seller and the buyer because of the existence of rights or claims which relate to industrial or intellectual property or the like, thereby excluding the application of article 19 to such "non-conformities". Consequently, national law will apply; it differs considerably in various countries and may not be very well suited to the particular aspects of these questions in international trade. The ICC therefore favours the previous version, i.e. the deletion of article 7, paragraph (2) or, as a second choice, its deletion together with the introduction of a second paragraph in article 25 saying that the seller is not liable to the buyer in respect of rights or claims of third persons based on industrial or intellectual property. Thereby it would be made clear that the seller is not liable in such respect unless he has agreed thereto.

27. The ICC also thinks that article 25, as finally redrafted by the Working Group, is incomplete in so far as it does not spell out the consequences of the goods not being free from rights or claims of a third person. Some provisions as those in the previous article 25, paragraph (2) should therefore be reintroduced.

Article 23

28. The ultimate time-limit for giving notice about hidden defects practised in trade is usually one year, six months or even a shorter period depending on, *i.a.*, the nature of the goods involved. A period as long as two years is difficult to accept, as a general rule, and a strong wish has been expressed among consulted circles that the period not be longer than one year. If the two-year period is going to stand, it should be noted that shorter periods are frequently used in international trade and that the provision for a two-year period may not be interpreted as an attempt to change such practices.

29. The ICC expresses its satisfaction with the wording of paragraph (2) of article 23 as the fact of providing for a shorter period of guarantee in general is to be understood as a shortening of the period within which the buyer may rely on hidden defects in the goods.

Article 25

[See paragraph 27 of these comments.]

GENERAL OBSERVATIONS ON ARTICLES 26 TO 33

30. The doing away with the principle of *ipso facto* avoidance and its replacing by the rule that avoidance generally should take place only upon notice given by the party not in breach has met general approval in circles consulted by the ICC and the ICC therefore supports such change.

31. The Convention has introduced "a consolidated system" of remedies covering seller's failure to deliver as well as lack of conformity. Such system may at first look appealing because of its simplicity. It must be borne in mind, however, that delivery of defective goods and failure to deliver at all give rise to problems of different kinds and the rules in this connexion have to be more or less differentiated, as can be seen in connexion with giving notice and the loss of the right of avoidance. The preference for "a consolidated system of remedies" shown in the draft may therefore be more a matter of presentation than of substance. The ICC does not object to the approach now taken, provided that the remedies for different kinds of breaches, as non-delivery of goods, delivery of defective goods and non-payment, are differentiated sufficiently.

Articles 26 and 27

32. A significant change in the present draft as compared to ULIS is reflected in articles 26 and 27, which do not specify the nature of the performance which the buyer may require. As "performance" or request for performance (not to be confused with the possibility of having a court order for enforcement of specific performance, dealt with in article 12) may be differently understood in different legal systems, clarification is therefore needed in this respect, as in article 42 ULIS 1964.

33. The ICC wants to draw attention to one important aspect of this problem. Article 42 of ULIS 1964 provides that the buyer can request the seller to remedy defects in the goods. This certainly represents a novelty, compared to many legal systems and general conditions in use where the seller may *offer* to remedy a defect but where the buyer has *no right* to request the seller so to do. Since the provision in this connexion in article 42 ULIS 1964 has been deleted in the present draft, the most likely interpretation of it is that the buyer has no right to have the seller remedy a defect. He can, however, as said in article 27, require "substitute goods" when the lack of conformity constitutes a fundamental breach and the request is made within a certain time. To avoid any ambiguities it should be expressly stated as in article 42, paragraph (1) (*c*) ULIS 1964 that such right is limited to unascertained (generic) goods.

34. If on the contrary the present text is to be understood as imposing a duty on the seller to remedy defects in specific goods or in goods to be manufactured or to replace those goods, such duty must be contingent upon the possibility for the seller to remedy defects without unreasonable efforts or costs to himself.

GENERAL OBSERVATIONS ON ARTICLES 28 TO 30

35. The system of remedies available to the buyer for breach of contract by the seller as described in the following articles (28-30) is clearer than that in ULIS.

Article 28

36. The essence of article 28 is only that it states that after the buyer has requested the seller to perform, he must await the expiry of any period set by him before he may resort to any remedy inconsistent with his request. This goes without saying, but if it has to be stated expressly it should be possible to draft this more adequately.

37. Within circles consulted by the ICC as to which should be the effect of a request of the buyer to the seller

to deliver without any time period for such delivery being indicated in the request, the majority believes that such request could only be understood as readiness to receive the goods if delivery follows promptly. This seems now to be adequately reflected in the present text, as article 28 refers only to the case where the buyer has fixed an additional period of time and not to a general request for delivery. Although this is not expressly stated in article 28, the provision must be understood to mean that if performance follows immediately upon a request, the buyer cannot avoid the contract because of late delivery.

Article 29

38. The situation in article 29, paragraph (2), however, is different. If the buyer does not reply to a question of the seller as to whether he is prepared to take delivery, such silence on the buyer's part reasonably can be deemed to extend the seller's right to deliver within a time period indicated in the request. If no time period has been indicated by the seller, his inquiry with the buyer should have no extending effect on his right to deliver at all. The deletion of the words "or . . . time" in paragraph (2) as well as of the corresponding phrase in paragraph (3) is therefore recommended.

Article 30

39. Article 30, paragraph (1) (*b*) gives the buyer the right, irrespective of whether the seller's breach is fundamental or not, to avoid the contract if the seller "has not delivered the goods" within an additional period set by the buyer. According to its wording this rule is restricted to cases where the goods in their entirety have not been delivered. Even so restricted, the rule may sometimes lead to hardships when it applies to goods to be manufactured by the seller especially for the buyer. If only a part is missing or a defect has not been remedied within an additional period, the situation should come under (*a*) and a fundamental breach should be a prerequisite for any avoidance. Otherwise a way would be opened for transforming every non-fundamental breach into a fundamental breach by the setting of an additional period.

40. The ICC has further noted that the provisions about loss of right of avoidance have been reintroduced in the latest draft presented by the Working Group. In the view of the ICC, it should not be possible for the buyer to keep such right of avoidance pending for an indefinite time. Such right to avoid the contract should be forfeited if it has not been exercised within reasonable time after delivery either after discovery of the defect or, if the seller has tried to cure any defect in the goods, after his unsuccessful attempt. This seems, to the satisfaction of the ICC, to be adequately reflected in the present text.

Article 36

41. Article 36 provides that in the case where no price has been agreed upon, the price prevailing at the time the contract was concluded should be applied.

42. In commercial relations the price at the time of delivery is generally understood as definitive, and a change along those lines is therefore recommended.

Article 45

43. Article 45 gives rise to two different delicate problems:

(*a*) When does the right for the seller to avoid the contract arise, and

(*b*) Once arisen, can the right be forfeited because it has not been exercised in time?

44. As to the first question, one may doubt whether the seller should have the right to take back the goods from the buyer once he has allowed him to take possession thereof. In any case it seems unreasonable to allow the seller to take back the goods unless the buyer has failed to pay the price within an additional period set by the seller, and article 45 should be amended accordingly.

45. In cases where the buyer has not yet taken delivery of the goods, one could, as the present text provides, be stricter against the buyer and let a fundamental breach give rise to an immediate right to avoid the contract.

46. As to the time within which the seller has to exercise such right of avoidance, the ICC believes that some limit must be set on it; likewise, in cases where delivery has been made but payment is still missing. The seller should react within a reasonable time after the discovery of the breach and then make his choice upon the expiry of an additional period set by him or set out a new additional period. The ICC therefore recommends that the present text be amended accordingly.

Articles 47 to 49

47. According to article 47 a party may suspend the performance of his obligation when, after the conclusion of the contract, a serious deterioration in the capacity to perform or the creditworthiness of the other party or his conduct in preparing to perform or in actually performing the contract gives reasonable grounds to conclude that the other party will not perform a substantial part of his obligation.

48. Some right of suspension of performance in case of breach or anticipatory breach is indeed indispensable. The ICC fears, however, that the present provision could be abused by one party to request security from the other party, e.g. letter of credit or a performance guarantee, when such security was not contracted for at the time of the conclusion of the contract. According to article 49, only when it is clear that the breach will be a fundamental one may the contract be avoided. With the help of the procedure envisaged in article 47, paragraphs (1) and (3), however, a party could suspend its performance if the other party's conduct in preparing to perform gives "grounds to conclude that the other party will not perform a substantial part of his obligations" and then the first party could proceed to avoidance under paragraph 3. It is believed that the right to avoid the contract under the last sentence of paragraph 3 should be limited as in article 49 to cases where the anticipatory breach is clear. It is therefore recommended that the last part of paragraph (3) (after the word "thereof" in the first sentence) and every reference to "adequate assurance" be deleted and instead, that the general rule in article 49 be relied upon.

Article 50

49. The exemption clause in article 50, although somewhat vague, is quite in line with *force majeure* clauses commonly used, and may be considered an improvement over article 74 ULIS 1964, which referred to some very hypothetical situations.

50. The exemption covers only liability in damages. The final relief from duty to perform would depend on circumstances such as whether performance is definitely impossible or the conditions have so radically changed that performance amounts to performance under a different contract (frustration). The ICC agrees that no attempt should be made to cover such cases. The choice as to avoiding the contract should lie with the party who performs it and not with the non-performing party.

51. Article 50 does not limit the other party's right to avoid the contract. In that respect a non-performing party who wants to limit his liability has to rely on contractual provisions.

52. To restrict liability to "fault" alone would probably be going too far, but as the term has been defined in the text in a specific way, any objection to the use of it may be more a matter of drafting than of substance. From business contracts the expression "beyond the control of a party" is more familiar and would therefore be preferable to "fault".

53. It is believed that the wording as a whole could be improved in the following way:

> "Where a party has not performed one of his obligations he shall not be liable for damages for such non-performance if he proves that it was due to circumstances beyond his control which he could not reasonably have taken into account at the time of the conclusion of the contract and the consequences of which he cannot reasonably be expected to prepare against or to overcome."

54. The clause about failure of a subcontractor to meet his obligations seems to correspond to what is frequently practised and is not believed to meet with any objection.

55. The ICC would like to stress that article 50 may be looked upon not as making exemption clauses of a contractual nature superfluous but as laying down some general principles and offering some protection when contracts are concluded without the help of extensive written documents. It may therefore be accepted to have a rather narrow clause as it is easier to restrict liability by a contractual arrangement than to enlarge it.

Article 55

56. Article 55 as article 82 ULIS 1964 limits damages to the loss which the party in breach ought to have foreseen at the time of conclusion of the contract. It may be doubted what the result of such restriction would be and whether it would be equitable, e.g. when applied to loss of profits on the buyer's part, to overtime pay which the buyer may have to pay to his workers to avoid delay on his side, to delivery fines and other forms of compensation which a seller may have to pay to his buyer, or to currency depreciations when buyer is in delay with payment, etc. Consideration might therefore be given to deleting the restriction in the last sentence of article 55 and relying on a provision of a more general nature. To delete any limitation of the loss for which one party has to compensate the other, would, however, not be advisable.

Article 58

57. The present rule in article 58 is an improvement over the rule in article 83 ULIS 1964. To add only 1 per cent to the official discount is much too little, as in many countries 2-3 per cent is generally added. As the seller, alternatively, may rely upon the rate applied to unsecured short-term commercial credits in his country, the article as a whole nevertheless is acceptable. It is recommended, however, that the surcharge be increased to at least 2 per cent.

Articles 64 to 67

58. See above, paragraphs 16 to 22.

E. Report of the Secretary-General: analysis of comments by Governments and international organizations on the draft convention on the international sale of goods as adopted by the Working Group on the international sale of goods (A/CN.9/126)*

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* 7 April 1977.

Introduction

1. In accordance with a decision taken by the Commission at its eighth session (1-17 April 1975), the text of the draft Convention on the International Sale of Goods adopted by the Working Group on the International Sale of Goods at its seventh session (5-16 January 1976) was transmitted to Governments and interested international organizations for their comments.[1]

2. As at 28 March 1977 comments had been received from the following Governments: Australia, Austria, Bulgaria, Finland, Germany, Federal Republic of, Hungary, Iraq, Madagascar, Netherlands, Norway, Pakistan, Philippines, Poland, Sweden, Union of Soviet Socialist Republics, United States of America, Yugoslavia and Zaire, and from a non-governmental organization, the International Chamber of Commerce (ICC). These comments have been reproduced in documents A/CN.9/125 and Add.1.*

3. At its eighth session, the Commission also requested the Secretariat to prepare an analysis of such comments for consideration by the Commission at its tenth session. The present document contains such an analysis.

4. In preparing the analysis, the comments have been arranged by articles and within each article by paragraphs or subparagraphs or, where appropriate, by subject-matter. Where the comments concerned the article as a whole, and not a particular paragraph of an article, they were analysed under the heading "article as a whole".

5. Where a proposal for the modification of the existing text of the draft Convention set forth a draft text to effect such modification, the analysis reproduces the proposed draft text only if it involved a modification of substance. Drafting suggestions which did not involve a modification of substance are neither reproduced nor described in the analysis. However, the name of the Government or organization which made the drafting suggestion is noted at the end of the discussion of the article or paragraph of an article to which the drafting suggestion pertained. The exact wording of a proposal can be ascertained by reference to the comments of the respondent concerned appearing in documents A/CN. 9/125 or Add.1.

Analysis of comments

A. Comments on the draft Convention as a whole

1. The majority of the respondents express the view that the provisions are, in general, acceptable (Australia, Austria, Finland, Germany, Federal Republic of, Hungary, Iraq, Madagascar, Norway, Sweden, United States of America, Yugoslavia, ICC). All these respondents indicate that particular problems still exist which are not resolved by the draft in its present form, and suggest appropriate solutions to resolve these problems.[2] No respondent expresses the view that the draft Convention is unacceptable.

2. The following reasons are given by the respondents mentioned above for their general approval of the draft Convention:

(*a*) That the draft Convention constitutes a suitable basis for the adoption of a new convention regulating the international sale of goods (Australia, Finland, Germany, Federal Republic of, Hungary, Norway, Sweden, United States of America, ICC);

(*b*) That the rules contained in the draft Convention relating to the issues dealt with therein are, in general, an improvement on the corresponding rules contained in the Uniform Law on the International Sale of Goods (ULIS) (Austria, Finland, Norway, Sweden);[3]

(*c*) That a new convention based upon the draft would probably attract wider acceptance than has ULIS (Australia, Norway, Yugoslavia, ICC);

(*d*) That the draft Convention would facilitate international trade by resolving legal problems currently encountered in the international sale of goods (Hungary, ICC);

(*e*) That the draft Convention has been developed with the participation of States reflecting a wider range of interests and of legal and economic systems than had ULIS (Hungary, Yugoslavia);

(*f*) That the draft Convention proceeds from the idea of the establishment of a new international economic order (Yugoslavia);

(*g*) That the draft Convention reflects an equitable balance between the different legal systems (Finland, Hungary, Yugoslavia);

(*h*) That the draft Convention as a whole reflects a balanced and carefully elaborated compromise between the sometimes conflicting interests of the parties to a contract for the sale of goods (Finland, Hungary, Yugoslavia).

Relationship with ULIS

3. The International Chamber of Commerce (ICC)[4] (para. 2) stresses the importance of the fact that a number of States have already ratified ULIS and that, therefore, unless there are compelling reasons, the new text should not differ from ULIS. ICC further states that it is important that in the elaboration of the transitional provisions, due consideration be given to the situation of States which have already ratified ULIS and the difficulties for these States of replacing the earlier convention by the new one.

4. Sweden (para. 8) states that the present draft Convention should be prepared in such a manner that it would be possible for a State bound by ULIS to become a party to it.

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* Reproduced in this volume, Section D above.

[1] The text of the draft Convention is found in A/CN.9/116, annex I (Yearbook . . ., 1976, part two, I, 2).

[2] These observations are noted below under the respective articles of the draft Convention.

[3] The Uniform Law on the International Sale of Goods annexed to the Convention relating to a Uniform Law on the International Sale of Goods, The Hague, 1964 (*United Nations Register of Texts of Conventions and other Instruments concerning International Trade Law*, vol. I, chap. I; United Nations publication, Sales No. E.71.V.3).

[4] The references are to the paragraph in the comments of the Government or the international organization concerned as reproduced in A/CN.9/125 or Add.1.

Relationship with the Convention on the Limitation Period and a future convention on the formation and validity of contracts

5. Australia (para. 3) and Norway (para. 4) support the approach taken by the Working Group that the draft Convention should, wherever possible, conform to the parallel provisions in the Convention on the Limitation Period. Australia, however, states that the provisions of that Convention should not be emulated at the cost of including in the present draft provisions that are not wholly appropriate. Norway, on the other hand, suggests that since the Commission or the future conference of plenipotentiaries might wish to adopt, in respect of some points in the proposed Convention on the International Sale of Goods, a formulation different from that in the Convention on the Limitation Period, the terms of reference of the future conference of plenipotentiaries should be extended to include consideration of certain possible amendments to the Convention on the Limitation Period in order to keep the wording of the two conventions uniform.

6. The Federal Republic of Germany (para. 3) suggests that the draft Convention on the International Sale of Goods should be co-ordinated with the future convention on formation and validity of contracts for the international sale of goods and that work on that project should be so speeded up that the latter convention could be considered at the same diplomatic conference as the draft Convention on the International Sale of Goods.

Relationship with the Hague Convention of 1955

7. Norway (para. 5) suggests that a right of reservation should be permitted in respect of the Hague Convention of 1955 on the applicable law in the field of international sale of goods.

Commentary on the draft Convention on the International Sale of Goods

8. The United States (paras. 2-7) proposes that a commentary be submitted with the draft articles to the General Assembly and that the text adopted by a diplomatic conference should be accompanied by a commentary. It is stated that the commentary would be extremely useful during the period when legal and business circles were considering whether to recommend ratification of the Convention by their Governments and, after the text has entered into force, it would help in promoting uniformity. The United States states that if a commentary does not accompany the text when it leaves the Commission, it will find it necessary to propose a considerable number of changes to the text to make it more detailed and to add cross-references.

9. The Netherlands (paras. 2-3) suggests that the commentary be made more complete by explaining why the modifications of and deletions from ULIS were thought necessary and what would be the practical effect of these differences between the draft Convention and ULIS.

Uniform law rather than convention

10. ICC (para. 3) expresses the view that the draft Convention should be presented in the form of a uniform law rather than a convention since, in their view, the ultimate goal of uniformity is more definitely achieved with a uniform law which would apply to the buyer and seller than by a convention which would apply to Contracting States.

Titles to sections

11. The Philippines (para. 1) and the United States (para. 6) suggest that all articles should have titles. The United States goes on to suggest that the titles to the articles should be placed in the commentary in brackets so as to indicate that they do not form part of the text of the articles themselves.

Terminology

12. Australia (para. 7) and the United States (para. 19) note that there are several different terms and expressions used in the draft Convention dealing with knowledge and constructive knowledge, the differences in meaning of which are not clear. Australia proposes that the draft Convention contain a standard, preferably by a definition, by reference to which particular states of mind are to be imputed. The United States proposes deleting "contemplated" in articles 6 (*a*) and 48 (2) and "had reason to know" in articles 2 (*a*) and 8 (2) in favour of "foreseen" and "ought to have known".

13. Yugoslavia (para. 8*b*) states its approval of the fact that at a number of places in the text of the draft Convention the term "short time" has been replaced by "reasonable time".

Clarity of drafting

14. Sweden (para. 3) notes that the draft Convention had a certain lack of clarity and precision. It notes, however, that a fairly high level of abstraction and vagueness was inevitable in rules that are to apply to a large number of States whose legal, social and economic systems differed. Nevertheless, Sweden recommends revising the text to make it as clear and stringent as possible.

General conditions

15. Pakistan (para. 1) suggests that it would be useful and desirable if, in the light of this Convention, the Commission would draw up general/specific contract specimens for use in international trade.

Inspection bodies

16. Pakistan (para. 2) states that it would be helpful if Member States were advised to create inspection/examination bodies in their respective countries in collaboration with the Chamber of Commerce and Industry for checking of quality, quantity, packing, delivery, conformity with samples, etc., which bodies would be liable along with the seller for any failure in respect of those matters.

States which have common legal rules

17. Sweden (para. 8) proposes that States which have common legal rules in respect of the sale of goods, such as Sweden, Denmark and Norway, should be able to

reserve the right to consider themselves as one State for the purposes of the Convention and therefore not be bound to apply this Convention to contracts for the sale of goods between themselves.

B. Comments on the provisions of the draft Convention

PART I. SUBSTANTIVE PROVISIONS

Chapter I. Sphere of application

ARTICLE 1

Article as a whole

1. Hungary (para. 6) and ICC (para. 4) state their approval of the scope of the application provisions.

2. Australia (paras. 4-5) suggests in respect of article 5 that careful consideration be given to the possibility that the draft Convention would apply to a transaction only if it was made so applicable by the parties to the transaction. Otherwise States which view the draft Convention quite favourably as a whole but which have reservations concerning particular issues might be reluctant to accede to it if its application is automatic.

Paragraph (1)

3. Bulgaria (para. 1) and the Philippines (paras. 2-3) suggest that the parties must not only have places of business in different States but also have different residences (Bulgaria) or be of different nationalities (Philippines). Bulgaria suggests that it is contrary to the aims of the proposed Convention for it to apply to two enterprises of the same nationality and residence even though one, or both, of the enterprises has places of business in different countries. The Philippines propose that article 1 (1) should read:

> "(1) This Convention applies to contracts of sale of goods entered into by parties of different nationalities whose places of business are in different States:"

4. ICC (para. 6) comments on the definition of "place of business" as found in article 6 (*a*) and Madagascar (para. 2) and ICC (para. 7) comment on the criterion of "closest relationship" as that term is used in article 6 (*a*). These comments are described in paragraphs 1 and 2 of the analysis of article 6.

5. The Netherlands (paras. 4-6) proposes reinstating the requirement found in article 1 of ULIS that the contract must possess one of the international aspects specified in that article. Without such a requirement the proposed Convention implies that it is applicable to a contract of sale which has been concluded in a country in which either the buyer or the seller has his place of business and in which the other party is temporarily present even though the goods are already in that country and delivery is to take place there. The Netherlands concludes that it is doubtful whether such a contract has sufficient international elements that it should fall within the sphere of application of the proposed Convention.

Paragraph (1) (b)

6. ICC (para. 5) states its approval of this provision that the draft Convention applies if the rules of private international law lead to the application of the law of a contracting State. It states that article 2 of ULIS which excludes the rules of private international law for the purpose of application of the uniform law, instead of leading to uniformity, results in a complicated system of reservations and in some circles has made ULIS unacceptable.

7. The Federal Republic of Germany (paras. 4-6) proposes the deletion of paragraph (1) (*b*). It states that the draft Convention should be limited to cases in which the parties to a contract of sale have their places of business in different contracting States. It also notes that States would be free to apply the draft Convention if the rules of private international law lead to the application of the law of that State, but that they should not be required by the draft Convention to do so. Furthermore, the Convention on the Limitation Period in the International Sale of Goods provides for application only between contracting States.

Paragraph (2)

8. Pakistan (para. 3) states that the place of business of the parties should be clearly defined in order to prevent triangular business which occurs in the case of re-export to a third State by the buyers.

9. The USSR (para. 1) submits a drafting proposal.

Proposed paragraph (3)

10. Norway (paras. 13-14) proposes that article 6 (*c*) be deleted and that a new article 1 (3) be inserted to read as follows:

> "(3) The Convention applies regardless of the nationality or the civil or commercial character of the parties or of the contract."

Norway states that this change would make it possible to take into consideration the civil or commercial character of the parties or of the contract for such purposes as determining the reasonable time for giving notice to the other party.

ARTICLE 2

Article as a whole

1. The Philippines (para. 4) suggests that the term "goods" should be defined in order to determine what goods will not be subject to the draft Convention.

2. The USSR (para. 2) suggests that consideration should be given to the advisability of including in the draft Convention provisions similar to those in article 5 of the Convention on the Limitation Period. Those provisions exclude claims based upon:

(*a*) Death of, or personal injury to, any person;

(*b*) Nuclear damage caused by the goods sold;

(*c*) A lien, mortgage or other security interest in property;

(*d*) A judgement or award made in legal proceedings;

(*e*) A document on which direct enforcement or execution can be obtained in accordance with the law of the place where such enforcement or execution is sought;

(*f*) A bill of exchange, cheque or promissory note.

Paragraph (a)

3. The USSR (para. 2) recommends that the text of this provision should be identical to that of article 4 of the Convention on the Limitation Period, namely:

"(*a*) of goods bought for personal, family or household use;"

4. The Netherlands (para. 7) states that the commentary does not make it clear why it is desirable to exclude from the application of the draft Convention a contract of sale concluded by correspondence between a sales agency and a buyer having his place of business in another country and thus to make it subject in principle to the legislation of the seller's country.

5. The United States (para. 19) makes a drafting proposal.

Paragraph (e)

6. Finland (para. 3), Norway (paras. 6-7) and the Philippines (para. 4) propose the deletion of paragraph (*e*) so that the draft Convention would apply to the sale of ships and aircraft. Alternatively, Norway proposes that paragraph (e) be drafted as follows:

"of any used ship or vessel which is, at the time of the conclusion of the contract, registered in a national [official] public register as having a gross tonnage of 10 tons or more;"

Paragraph (f)

7. Finland (para. 4) and Norway (para. 6) propose the deletion of this paragraph.

8. The USSR (para. 2) proposes that the word "gas" should be inserted in this paragraph since the terms of contracts for the sale of gas are *sui generis*.

Article 4

1. The Federal Republic of Germany (paras. 7-8) and Norway (paras. 8-9) note that article 4 may give rise to the mistaken belief that an agreement between the parties that the draft Convention should apply will result in setting aside the mandatory provisions of national law. The Federal Republic of Germany notes that this might occur even in the case of a domestic sales contract which has no connexion with a foreign country. Therefore, it proposes the deletion of article 4. Norway, on the other hand, proposes that article 4 be amended to read as follows:

"The present Convention shall also apply where it has been chosen as the law of the contract by the parties, to the extent that this does not affect the application of any mandatory provision of law which would have been applicable if the parties had not chosen the law."

2. The Federal Republic of Germany (para. 9) and Norway (paras. 10-12) also make proposals in respect of article 7 (1) which are based on the same concerns.

Proposed article 4 bis *on choice of law*

1. Poland (para. 9) proposes that a new article should be adopted to the effect that, unless the parties agreed otherwise, the law of the seller's country is to be regarded as the proper one with respect to a contract of sale of goods. Poland points out that this principle is commonly recognized in international trade.

2. The USSR (para. 17) makes a similar suggestion in that the law of the seller's country should apply to those questions which are not regulated or are only partly regulated by the Convention. The USSR suggests that such a provision might be made part of article 13 on the interpretation of the Convention.

3. In its comments on article 7 Norway (para. 10) notes that article 7 (1) does not solve the choice of law problem as would the Norwegian proposed amendment to article 4 (see para. 1 of the analysis of article 4). However, Norway suggests this problem might perhaps be left to national law and not be solved in the proposed Convention.

4. In its general comments Norway (para. 5) notes that a right of reservation to the present Convention should be opened in respect of The Hague Convention of 1955 on the applicable law in the field of international sale of goods.

Article 5

1. Australia (paras. 4-5) suggests that careful consideration be given to the possibility that the proposed Convention would apply to a transaction only if it is made so applicable by the parties to the transaction. Otherwise States which view the draft Convention quite favourably as a whole but which have reservations concerning particular issues may be reluctant to accede to it if its application is automatic.

2. Zaire (para. 3) expresses its approval of article 5 which, because of the differences in legal systems, gives States the option of not applying any given provision.

3. The Philippines (para. 5) proposes that after the term "exclude" the words "by express stipulation" should be added so as to indicate clearly that exclusion, derogation or varying of the provisions of the draft Convention may not be done by implication.

Article 6

Paragraph (a)

1. ICC (para. 6) states that it is important that there be a clear indication as to what constitutes a "place of business". It suggests that in order to qualify as a "place of business", there should be maintained a permanent business organization including localities and employees for the purpose of the manufacture or sale of goods or services. Such a place of business, usually called a branch, should be confused neither with a subsidiary which is a distinct legal entity, nor with "a permanent establishment" as it is defined under numerous double taxation agreements, e.g. the presence of an agent with power to conclude a sale.

2. Madagascar (para. 2) and ICC (para. 7) suggests that the criterion of "closest relationship" to the contract is unclear. ICC goes on to say that a place of business should be relevant for the application of the draft Convention only if the contract is concluded in the name of that place of business.

3. The United States (para. 19) submits a drafting proposal.

Paragraph (b)

4. Pakistan (para. 4) states that, instead of making reference to habitual residence, it is necessary to define clearly the meaning of a place of business.

Paragraph (c)

5. Norway (paras. 13-14) proposes the transfer of paragraph (*c*) to a new article 1 (3). See paragraph 10 of the analysis of article 1.

6. The Philippines proposes that, if its suggestion in respect of article 1 is accepted (see para. 3 of the analysis of article 1), the words "the nationality of the parties nor" should be deleted from paragraph (*c*).

ARTICLE 7

Paragraph (1)

1. The Federal Republic of Germany (para. 9) suggests that it is necessary to determine whether additional matters should be excluded from the sphere of application of the proposed Convention. For instance, national laws for the protection of the buyer purchasing on an instalment plan or "at the front door" should take precedence over the draft Convention. Most, but not all, of these cases are solved satisfactorily by the exclusion of the consumer purchase in article 2 (*a*) and the exclusion of the rules on the validity of contracts of sale in article 7 (1). However, the Federal Republic of Germany states that when drafting any such exclusion of the application of the proposed Convention in favour of national laws for the protection of consumers, care will have to be taken to preserve the justified interests of international trade in a clear delineation of the sphere of application.

2. Norway (paras. 10-12) proposes: (i) that words be inserted to indicate that the proposed Convention not only is not concerned with the validity of the contract, but also is not with the validity of any additional or subsequent agreement of the parties relevant to the sale; (ii) that the words "In particular this Convention is not," at the beginning of the second sentence be deleted as being misleading in relation to questions of validity, which are mandatory law; and (iii) that reference to the validity of a usage be transferred to a new article 8 (3). With some additional drafting suggestions proposed by it, Norway suggests that paragraph (1) should read as follows:

> "(1) This Convention governs only the rights and obligations of the seller and the buyer arising from a contract of sale. Except as otherwise expressly provided therein, the Convention is not concerned with:
>
> "(*a*) The formation of the contract;
>
> "(*b*) The validity of the contract or of any provision contained therein or in any other agreement relating to the sale;
>
> "(*c*) The effect which the contract may have on the property in the goods sold."

3. Norway (para. 10) also notes that article 7 (1) does not solve the choice of law problem, as would the Norwegian proposed amendment to article 4. However, it suggests that this problem might perhaps be left to national law and not be solved in the proposed Convention.

Paragraph (2)

4. Madagascar (para. 3) proposes the retention of article 7 (2) since questions of the effect of the contract on the property in the goods sold and on industrial or intellectual property often bring into play purely domestic considerations that vary from State to State and are difficult to resolve.

5. On the other hand, Australia (para. 6), the Federal Republic of Germany (paras. 10-11), ICC (paras. 25-26), and the USSR (para. 3) propose the deletion of article 7 (2) so that the question of the rights and obligations of the seller and the buyer arising out of the existence in any person of rights and claims which relate to industrial or intellectual property or the like would be covered by the proposed Convention. The Federal Republic of Germany and ICC make additional comments as follows:

(*a*) The Federal Republic of Germany (para. 10) indicates that, if article 7 (2) were deleted, article 25 on the seller's obligation to deliver goods free from the rights of third persons would control, a result which is stated to be justified.

(*b*) ICC (paras. 25-26), however, indicates that, if article 7 (2) were deleted, the matter would be governed by article 19. The existence of third party rights in industrial or intellectual property (or administrative regulations which restricted use of the goods) might render the goods unfit for use. According to article 19 (1) (*a*), the question would be whether the goods were unfit for the purposes for which they would ordinarily be used. However, the question whether they would be unfit for the particular purpose of being used in the buyer's country would have to be answered by application of article 19 (1) (*b*), which exempts the seller from liability when it was not reasonable for the buyer to rely on the seller's skill or judgement when deciding whether to purchase the goods.

(*c*) Therefore, ICC favours the deletion of article 7 (2) with no further action. As a second choice, it would couple the deletion of article 7 (2) with the introduction of a new article 25 (2) stating that the seller is not liable to the buyer in respect of rights or claims of third persons based on industrial or intellectual property.

6. Finland (para. 5) and Norway (para. 12) propose that article 7 (2) be amended to begin as follows:

"(2) Except as otherwise provided in article 25 paragraph (2), . . ."

(*a*) Norway also submits a drafting proposal that the words "which relate" be deleted and the word "relating" be inserted.

(*b*) In its discussion of article 25, Finland (para. 9) proposes that the Convention provide either (i) that the seller is not liable for the loss caused to a buyer arising out of the fact that a third person had a right in the goods based on industrial or intellectual property, or (ii) that the seller is responsible to the buyer in respect of rights or claim of a third party based on industrial or intellectual property to the extent such rights or claims arise out of, or are recognized by, the law of the State where the seller has his place of business.

(*c*) In order to implement its suggestion, which was identical to the second alternative proposed by Finland, Norway (para. 18) proposes that a new article 25 (2) be inserted as follows:

> "(2) Whether a right or claim of a third person based on industrial or intellectual property amounts to a breach of contract by the seller, is determined according to the contract and the law of the State where the seller has his place of business at the time of the conclusion of the contract. The effects of such a breach are determined by the provisions on lack of conformity in this Convention."

7. Norway (paras. 18-19) and ICC (para. 27) also consider the question as to what remedies the buyer should have for breach of the seller's obligation under

the proposed article 25 (2). See the analysis of article 25, paragraph 5.

Chapter II. General provisions

ARTICLE 8

Article as a whole

1. Yugoslavia (paras. 10-11) expresses its approval of the deletion of the second sentence in paragraph 2 of article 9 of ULIS, under which usages prevail over the Uniform Law since usages "as it is well known, were created by the economically strong groups having positions of power on the world market". Yugoslavia queries, however whether the same result does not arise from the current text. It states, therefore, that it is indispensable to give careful consideration to the significance and impact of article 8 (2) of the draft Convention.

2. ICC (para. 8) states that it is important that the proposed Convention state the role which usages play in the determination of the legal relations between buyer and seller. Usages are as important for doing justice to the buyer as to the seller and quite independently of whether a party has its place of business in an industrialized country or in a developing country. ICC concludes that the essence of any rule as to usages is that the newcomer in the trade should not be able to plead his ignorance of the usages as a defence.

Local usages

3. ICC (para. 8) states that it is regrettable that article 8 does not deal with local usages. It notes, however, that it is its understanding that even under the present text so-called local usages are to be taken into consideration in some situations, e.g. where they are internationally known. ICC also states that, because article 8 represents a compromise which has been difficult to reach, it finds the present text acceptable.

Trade terms

4. Yugoslavia (para. 12) and ICC (paras. 9-11, 21) propose the reintroduction of paragraph 3 of article 9 of ULIS which provides:

> "Where expressions, provisions or forms of contract commonly used in commercial practice are employed, they shall be interpreted according to the meaning usually given to them in the trade concerned."

5. ICC proposes that, if this text is not acceptable, an alternative, previously proposed by some representatives at the second session of the Working Group (A/CN.9/52, para. 82; Yearbook . . . , 1971, part two, I,A,2), be adopted as follows:

> "Where expressions, provisions or forms of contract commonly used in commercial practice are employed, the meaning usually given to them in the trade concerned shall be used in their interpretation in accordance with the provisions of paragraphs 1 and 2."

6. ICC (para. 11) notes that either provision would avoid two things: that trade terms might be interpreted with the help of the proposed Convention (e.g. by using the rules on the passage of the risk of loss as found in articles 64-67 of the draft Convention) and that local or national standards of interpretation might take precedence over international standards. ICC (para. 21) also notes that it understands that when a given delivery term such as "ex works", "FOB" or "CIF" has been agreed upon, even under the current text, the interpretation thereof is to be made with reference to the usages referred to in article 8. Sweden (para. 9) states that a provision should be inserted in article 8 to achieve these results, but does not specifically propose the reintroduction of article 9 (3) of ULIS.

Validity of usages

7. Norway (paras. 11 and 15) in discussing article 7 states that as regards the validity of a usage, the provision could well be transferred to a new paragraph (3) of article 8. It proposes a new text as follows:

> "(3) This Convention is not concerned with the validity of any usage."

ARTICLE 9

1. Hungary (para. 6) notes its approval of article 9, whilst ICC (para. 12) accepts it as a considerable improvement over the definition of "fundamental breach" in article 10 of ULIS which, it states, is too artificial and difficult to apply. Nevertheless, ICC regrets the vagueness of the present definition.

2. Austria (para. 2) and the Netherlands (paras. 8-9) express preference for the definition of "fundamental breach" in article 10 of ULIS. They make the following comments:

(*a*) The Netherlands states that article 10 of ULIS gives greater security for the parties affected by the contract. It submits that the requirement in the present text that one party know whether "substantial" detriment has resulted or will result for the other party would be difficult both for the party who is required to have such knowledge and for the courts, who might render widely differing judgements in this regard.

(*b*) Austria proposes that, if article 10 of ULIS were adopted, the words "*de même qualité*" in the French version be deleted. They are not in the English text and they are both ambiguous and superfluous.

3. Yugoslavia (para. 13) states that the question raised by article 9 is that of the meaning of "substantial detriment" and how will it be determined. It notes the simplicity and easy comprehension of the definition of "fundamental breach" in the present text in contrast with article 10 of ULIS which is complicated, hard to comprehend and difficult to apply in practice. It also notes that the definition in the present text narrows the scope of the provision as compared with that in article 10 of ULIS which appears to cover a larger number of situations.

4. The Federal Republic of Germany (paras. 12-13) states that the term "fundamental breach of contract" is not elucidated by defining it through reference to the vague idea of a "substantial detriment". The decisive point for determining whether the injured party can declare the contract avoided should be whether the result of the breach of contract is that the injured party no longer has an interest in the performance of the contract and whether this could have been foreseen by the party committing the breach at the time of the conclusion of the contract. It proposes the following text in replacement:

> "A breach committed by one of the parties to the contract is fundamental if its result is that the other party has no further interest in the performance of

the contract and if the party in breach at the time of the conclusion of the contract, foresaw or had reason to foresee such a result."

5. The Philippines (para. 7) proposes the deletion of the words "and the party in breach foresaw or had reason to foresee such a result". Unless these words are deleted, the party in breach will always allege that he neither foresaw nor had reason to foresee the substantial detriment which occurred. It should be sufficient that the substantial detriment in fact occurred.

6. Austria (para. 3) suggests that if the current text is maintained, it should be clarified at which moment the party in breach must have foreseen or had reason to foresee the result in order for the breach to be "fundamental".

Article 10

Paragraph (1)

1. Zaire (paras. 10-11) states that it is necessary to determine what are the "means appropriate in the circumstances". Since there are several means of communication as well as several circumstances, the question arises whether it is sufficient to use any means of communication.

2. Norway (para. 17) proposes that the words "Notices provided for by" be deleted and replaced by the words "Communications under", which would have the effect of making this paragraph applicable to all communications called for by the proposed Convention and not only to notices. Norway also proposes that the word "the" in the phrase "by the means appropriate . . ." be deleted, which would reduce the implication that only one means of communication might be appropriate in the circumstances. The text of article 10 (1) as proposed by Norway is as follows:

"(1) Communications under this Convention must be made by means appropriate in the circumstances."

3. The United States (para. 10) proposes the deletion of article 10 (1) in conjunction with a redrafting of article 10 (3). The text of article 10 as proposed by the United States is set out in paragraph 11 of this analysis.

Paragraph (2)

4. The USSR (para. 4) proposes that this paragraph be redrafted to make it clear that no prior notice need be given before a declaration of avoidance is forwarded to the party in breach and that the notice must be in writing. The text it proposes is as follows:

"(2) A declaration of avoidance of the contract is effective only if it takes the form of written notice to the other party."

5. Pakistan (para. 5) states that for a declaration of avoidance of contract, the notice given by a party should be well in advance in order to assess the reasons for the avoidance of contract and to evaluate its genuineness.

6. Norway (para. 17) submits a drafting proposal.

7. As a result of its proposal to delete article 10 (1), the United States (para. 10) proposes that article 10 (2) be renumbered as article 10 (1).

Paragraph (3)

8. Finland (para. 6), Norway (paras. 16-17) and the United States (paras. 8-10) propose that article 10 (3) should apply to other notices and communications in addition to those already mentioned in that article.

9. Finland (para. 6) proposes that article 10 (3) should also apply to notices given pursuant to articles 16 (1), 27 (2), 30 (2), 45 (2), 48, 49 and 50 (4).

10. Norway (paras. 16-17) states that article 10 (3) should apply to notices given pursuant to articles 16 (1), 27 (2), 47 (3) and 50 (4). However, it should not apply to notices under articles 28, 29 (2) and (3), 44, 46 and 47 (3), second sentence. Norway states that it is not clear whether the provision should apply to notices under articles 63 (1) and (2) or 65 (2). Norway proposes, therefore, the following text:

"(3) Where notice of lack of conformity, of avoidance or of suspension or any notice required by articles 27 paragraph 2 or 50 paragraph 4 is sent by appropriate means within the required time, the fact that the notice fails to arrive within such time, or that its contents have been inaccurately transmitted, does not deprive the sender of the right to rely on the notice."

11. The United States (paras. 8-10) proposes that article 10 (3) should be made to cover all communications called for by the proposed Convention. Such a policy would assure that the question of lost or delayed transmissions would be treated uniformly by all courts and tribunals in respect of all communications. It would also preclude the possible interpretation of article 10 (1) that a notice which is sent by other than the means appropriate in the circumstances would be denied any effect even though it arrived in time although not by an approved means. Therefore, the United States proposes the deletion of article 10 (1), the renumbering of article 10 (1), the renumbering of article 10 (2) as article 10 (1), the redrafting of article 10 (3) to read as set out below and its renumbering as article 10 (2). The text of article 10 as proposed by the United States is as follows:

"(1) A declaration of avoidance of the contract is effective only if notice is given to the other party.

"(2) If any other notice, request or communication provided for by this Convention is sent by means appropriate in the circumstances within the required time, the fact that the notice fails to arrive or fails to arrive within such time or that its contents have been inaccurately transmitted does not deprive the sender of the right to rely on the notice."

12. Poland (para. 12) states that article 10 (3) ought to be amended in order to balance the rights and obligations of the parties to a contract of sale of goods.

Article 11

Comments of the Working Group on the International Sale of Goods

1. In the report of the Working Group on the International Sale of Goods on the work of its eighth session (A/CN.9/128, paras. 33-35)* the Working Group notes that the different language versions of article 11 of the draft Convention and of the parallel text of article 3 of the Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF) are not identical. The Working Group notes that the use of the expression "need not be evidenced by writing" in the English language version suggests that the article regulates only matters of evidence and of the proper form of the offer and the acceptance but that it does not overcome a

* Reproduced in this volume, part two, I, A, above.

national rule of law that a contract for the international sale of goods must be in writing either to be validly formed or to be enforceable before the courts of that country. It is further noted that the French language version uses the phrase "*aucune forme n'est prescrite pour . . .*" which suggests that the article goes to questions of validity and enforceability.

2. Awaiting the consideration by the Commission of article 11 of the present draft Convention, the Working Group decided to place in square brackets both article 3 of ULF and an alternative text proposed by the Secretariat. The alternative text proposed by the Secretariat is as follows:

"Neither the formation or the validity of a contract nor the right of a party to prove its formation or any of its provisions depends upon the existence of a writing or any other requirement as to form. The formation of the contract, or any of its provisions, may be proved by means of witnesses or other appropriate means."

3. The Working Group also notes that it might be possible to reach a compromise in relation to the problem of the form of contracts by retaining the substance of article 3 of ULF with a proviso that it does not overcome contrary provisions in the municipal laws of the place of business of either party.

Article as a whole

4. The Federal Republic of Germany (para. 14) and ICC (paras. 13-14) recommend that article 11 be retained as is.

5. The USSR (para. 5) proposes the deletion of article 11. It states that the question of the form of the contract should be regulated by the proposed Convention, on the Formation of Contracts for the International Sale of Goods. It goes on to state that if a decision is taken to retain a provision in the draft Convention on the form of contracts, that provision should stipulate that contracts must be in writing if so required by national legislation, even if the national legislation of only one of the parties to the contract so requires. The USSR also states that if the contract is not in writing, article 11 should provide either that the contract in such cases is void, or that the law of the State whose legislation requires that the contract be in writing should apply.

6. Bulgaria (para. 2) and the United States (para. 11) state that they accept article 11 as it is drafted. However, both of these States would add a second paragraph which would provide that the contract of sale should be in written form when the legislation of one of the parties so requires. The United States proposes the following text:

"(2) The provisions of paragraph (1) do not affect an otherwise valid restriction on the authority of a party to conclude a contract other than in a prescribed form or manner if that restriction is prescribed by statutory law of the State where the party has its place of business and is either known to the other party or is widely known and regularly observed by parties to contracts of the type involved."

7. The Philippines (para. 8) propose that for any sale to be enforceable it must be evidenced by writing, note or memorandum. It proposes the following text:

"A contract of sale to be enforceable must be evidenced by writing, note, or memorandum signed or acknowledged by the parties or their authorized agents, although it need not be subject to any other requirements as to form. It may be proved by means of proof generally recognized by the law of evidence."

Proof by means of witnesses

8. Madagascar (para. 4) and Yugoslavia (para. 16) state that they accept the first sentence of article 11 but propose that the second sentence be deleted. They state that proof by means of witnesses is unreliable.

9. Pakistan (para. 6) proposes that if a contract of sale is not evidenced by writing, the witness should be from the chamber of commerce or association of trade in respect of the commodity in question.

10. Zaire (para. 12) states that the proposed Convention should specify in article 11 which witnesses may prove a contract since the question arises whether witnesses might not be from States not parties to the contract.

ARTICLE 13

1. ICC (para. 15) states that the redrafting of article 17 of ULIS, which is now article 13 of the draft Convention, represents an improvement.

2. Poland (paras. 7-8) suggests that it would be advisable to precede article 13 by a general clause to the effect that in the interpretation and application of the stipulations of a contract, the intentions of the parties as well as the purpose they wish to achieve are to be taken into account.

Choice of law

3. For a suggestion by the USSR (para. 17) in respect of a choice of law provision which, it states, might go in article 13, see the analysis of proposed article 4 *bis*.

Chapter III. Obligations of the seller

ARTICLE 14

1. ICC (para. 16) states that the deletion of "conformity" as a prerequisite for "delivery" is welcomed by the ICC and that the suppression of the distinction between non-delivery or late delivery and delivery to the wrong place is also an improvement.

2. Pakistan (para. 7) states that the original documents should preferably be routed through authorized commercial banks to ensure realization of the amount in question.

Section I. Delivery of the goods and handing over of documents

ARTICLE 15

Definition of delivery

1. ICC (para. 17) notes that the current text no longer attempts to establish a general definition of "delivery", which would be very difficult, but gives a definition for a few of the more important cases.

2. The United States (para. 20) notes that article 15 as drafted might give the implication that article 15 defines the act of delivery. However, it states, the function of article 15 is to set out the acts required of the seller

to fulfil his obligation to deliver, parallel to the provisions of article 41 which set out the acts required of the buyer to take delivery. Indeed, in most cases where the buyer fails to come for the goods, the seller will resell them and there will never be delivery to the buyer in breach. The text proposed by the United States (which includes a drafting proposal, see also comments of the United States, para. 23 (*a*)) is as follows:

"If the seller is not required to deliver the goods at a particular place, the seller's obligation to deliver consists:

"(*a*) If the contract of sale involves carriage of the goods, in handing the goods over to the first carrier for transmission to the buyer,

"(*b*) If, in cases not within the preceding paragraph, the contract relates to

"(i) Specific goods, or

"(ii) Unidentified goods to be drawn from a specific stock or to be manufactured or produced,

and at the time of the conclusion of the contract the parties knew that the goods were at, or were to be manufactured or produced at, a particular place, in placing the goods at the buyer's disposal at that place;

"(*c*) In other cases in placing the goods at the buyer's disposal at the place where the seller had his place of business at the time of the conclusion of the contract."

Conformity of the goods

3. ICC (para. 16) and the Netherlands (para. 11) state their approval of the decision that conformity of the goods to the contract is not a requirement for delivery.

4. Bulgaria (para. 4), on the other hand, states that it is reasonable that, if the goods delivered do not conform with the contract, there should be no delivery, since the parties have agreed on clearly specified goods. The requirement of conformity will obviate the need to apply all the rules concerning guarantees in the event that the goods should be faulty.

Delivery and passage of risk

5. Sweden (para. 10) states that it is difficult to see why different conditions for delivery and for passage of risk have been laid down and suggests that it should be possible to co-ordinate the rules further. See also the comments of Bulgaria in paragraph 6 of this analysis.

Paragraph (a)

6. Bulgaria (para. 8) proposes that a provision be added to article 15 (*a*) and to article 65 (1) to the effect that delivery is made and the risk passes when the goods are handed over to the first carrier.

Paragraphs (b) *and* (c)

7. Bulgaria (para. 3) proposes that subparagraphs (*b*) and (*c*) should be amended so that delivery is made by the seller handing over the goods, as in ULIS, rather than "by placing the goods at the buyer's disposal". This would reflect the fact that the delivery is a bilateral act which can be made only with the participation of the buyer.

8. The United States (para. 20) notes that even though the seller has fulfilled his obligation to deliver by "placing the goods at the buyer's disposal" at a particular place, there has been no physical delivery because the goods have not been handed over to or taken over by the buyer. For the text proposed by the United States, see paragraph 2, above.

9. Pakistan (para. 8) states that in article 15 (*c*) the place of delivery should be clearly defined in the contract to avoid any misunderstanding.

ARTICLE 16

The Philippines (para. 9) and the United States (para. 23 (*b*)) submit drafting proposals.

ARTICLE 17

1. ICC (paras. 22-23) proposes that paragraphs (*b*) and (*c*) be amended by a provision that the seller has to give the buyer notice of the seller's choice of the date of delivery. ICC also proposes that if the buyer wants to claim damages because of late delivery, he should give notice thereof to the seller promptly (or at least within a reasonable time) after actual delivery.

2. Pakistan (para. 9) proposes that a clause might be added to this article to explain reasons in case of delay.

ARTICLE 18

Finland (para. 7) proposes the deletion of article 18 on the grounds that it is unclear whether this provision adds anything to the declaration in article 14.

Section II. Conformity of the goods

ARTICLE 19

Paragraph (1)

1. The United States (paras. 23 (*c*) and (*d*) submits two drafting proposals.

Subparagraph (1) (b)

2. ICC (para. 24) states that the expression "expressly or impliedly made known to the seller at the time of contracting" should be understood in the sense that the responsibility of the seller is engaged only when such particular purpose has been made clear to him. If this is not the understood meaning of this expression, it would be advisable to clarify the text in such direction.

3. The USSR (para. 6) proposes that paragraph (1) (*b*) should read: "(*b*) are fit for any particular purpose expressly made known to the seller at the time of the conclusion of the contract;".

Burden of proof

4. The Federal Republic of Germany (paras. 15-16) proposes a new paragraph which would deal with the party upon whom the burden of proof lies in a dispute about the non-conformity of the goods. It proposes a text as follows:

"(3) The seller has to prove that the goods delivered by him conform to the contract. However, if the buyer wants to rely on a lack of conformity which he discovered after the expiration of the period within which he had to examine the goods under article 22, the buyer has to prove this lack of conformity. The buyer is considered to have discovered the lack of conformity before the expiration of this period if he

has given the seller notice of the lack of conformity within a reasonable time after the expiration of this period."

Limitation of remedies

5. Norway (paras. 21-23) proposes a new article 26 (3), modeled on article 34 of ULIS, which would restrict the buyer to the remedies provided by this Convention in case of breach by the seller. Norway suggests that if the proposed text is felt to be appropriate only in case of non-conformity of the goods, it might be made into a new article 19 (3). For the text proposed by Norway, see paragraph 3 of the analysis of article 26.

Administrative regulations and industrial and intellectual property

6. ICC (paras. 25-26) states that in its view questions concerning the seller's responsibility for ensuring that the goods comply with administrative regulations or that the goods do not infringe industrial or intellectual property rights are governed by article 19. For a further description of the proposals of ICC on this point, see paragraphs 5 (*b*) and (*c*) of the analysis of article 7.

7. Under the proposals of Finland (para. 9) and Norway (para. 18) in respect of articles 7 (2) and 25 a determination that the seller has failed in his obligation to deliver goods free from the claims of a third party based on industrial or intellectual property would be treated as a failure to deliver goods which conform to the contract.

ARTICLE 21

Austria (para. 4) notes that, although the last sentence in article 21 expressly says that the buyer retains any right to claim damages as provided in article 55, article 29 (1) does not contain such a provision. Austria proposes, therefore, that since there is no reason to distinguish between the two articles, the provision should either be contained in both articles or, because the provision is not necessary, it should be in neither of them.

ARTICLE 22

Paragraph (1)

1. Finland (para. 8) proposes the deletion of the words "or cause them to be examined" on the grounds that there are several provisions in the proposed Convention where no reference is made to the fact that measures incumbent on a party to the contract might be taken by someone else. Finland sees no reason why such words should be in one such provision and not in the others.

Other comments

2. Pakistan (para. 11) states that examination before shipment of goods is preferable. Ex-destination examination may cause expense and complications.

ARTICLE 23

Paragraph (1)

1. Pakistan (para. 12) states that the term "reasonable time" wherever it occurs in the draft Convention should be clearly determined and defined.[5]

Paragraph (2)

2. ICC (para. 28) proposes that the period during which the buyer may give notice of a lack of conformity of the goods should be shortened from two years to one year since shorter periods than two years are frequently used in international trade.

3. ICC (para. 29) states its satisfaction with the wording of this provision to the extent that it provides that the fact that there is a shorter period of guarantee in the contract is to be understood as a shortening of the period within which the buyer may rely on hidden defects in the goods.

ARTICLE 25

Substantive proposals

1. The substantive proposals made in respect of article 25 have been described above in paragraphs 5 and 6 of the analysis of article 7.

Relationship with other provisions

2. The United States (para. 21) proposes that article 25 be relocated so that it either immediately precedes or immediately follows article 19. In that matter it would be made clear that, to the extent the context permits, the rules in articles 20-24 would be made applicable to the obligations imposed by article 25 in the same way as they are applicable to the obligations imposed by article 19.

3. Norway (para. 20) suggests that consideration should be given to the relation between article 25 and the preceding articles in section II, and in particular the relation to article 23 (2). It suggests comparing articles 52 and 53 of ULIS.

Remedies for breach of obligation under article 25

4. ICC (para. 27) states that article 25 as finally drafted by the Working Group is incomplete in so far as it does not spell out the consequences if the goods are not free from rights or claims of a third person. It proposes that some provision should be reintroduced similar to that in article 25 (2) as found in the report of the Working Group on the International Sale of Goods on the work of its sixth session (A/CN.9/100, annex I; Yearbook . . . , 1975, part two, I, 2).

5. Norway (para. 19) suggests the the buyer should have generally available the remedies under articles 26 to 33, as well as under articles 47 to 49, for breach of the seller's obligation under article 25. Questions arise as to whether articles 27 (2), 31 and 32 should be applicable to claims under article 25, but if the existence of third-party claims are understood to constitute a lack of conformity of the goods, as they should, these provisions would also apply. However, it is less clear whether article 30 (1) (*b*) should also be applicable to cases under article 25 since the third-party claim may be more or less well founded.

[5] The term "reasonable time" appears in articles 17 (*c*), 23 (1), 27 (2), 29 (2), 30 (2), 45 (2) (*b*), 46 (1), 46 (2), 47 (3), 48 (1), 50 (4) and 56 (1). Similar terms also appear in articles 28, 29 (3) and 44.

Section III. Remedies for breach of contract by the seller

General observations on section III

1. The Netherlands (para. 10) states its approval of the decision of the Working Group to consolidate the remedies of the buyer in one set of provisions.

2. The USSR (para. 18) suggests that the possibility be considered of combining the provisions concerning remedies for breach of contract by the seller (chap. III, sect. III) and remedies for breach of contract by the buyer (chap. IV, sect. III).

3. ICC (para. 31) notes that the consolidated system of remedies covering the seller's failure to deliver as well as his delivery of goods which did not conform to the contract may at first look appealing because of its simplicity. It notes, however, that delivery of defective goods and failure to deliver at all give rise to problems of different kinds and the rules in this connexion have had to be more or less differentiated in the present draft. Therefore, it states, the preference for a consolidated system of remedies shown in the draft may be more a matter of presentation than of substance. Nevertheless, ICC does not object to the approach now taken, provided that the remedies for different kinds of breaches are differentiated sufficiently.

4. Yugoslavia (para. 14) notes that the provisions dealing with sanctions in the case of breach of contract have been rendered more concise and simplified, but that they are less systematized or clear. Furthermore, as a result of reducing the number of articles, there are frequent references in the text to other articles of the proposed Convention. It finds that these references are a burden, especially to the businessmen to whom such an approach of cross-referencing is inconvenient.

5. Although Sweden (paras. 4-6) accepts the structure of the draft that all of the remedies for breach of contract by the seller are dealt with in one section and all of the remedies for breach of contract by the buyer are dealt with in another section, it finds that a number of adverse consequences follow from this structure.

ARTICLE 26

Article as a whole

1. The USSR (para. 7) states that if paragraph (1) is intended to mean that damages may be claimed in addition to the exercise of the rights provided in articles 27-33, and not as an alternative, then the meaning of paragraph (2) is not clear.

2. Pakistan (para. 14) states that the rules contained in paragraphs (2) and (3) should apply only if they are included in the contract.

Exclusivity of remedies

3. The Netherlands (para. 10) and Norway (paras. 21-23) propose the adoption of an additional provision similar to article 34 of ULIS that the buyer has no rights other than those conferred on him by the draft Convention. Norway proposes the following text as a new paragraph (3) of article 26 to come between the present paragraphs (2) and (3):

> "(3) The rights conferred on the buyer by this Convention exclude all other remedies based on lack of conformity of the goods [or on other failure by the seller to perform his obligations], except in case of fraud."

Norway suggests that if it is felt that this provision should relate only to cases of lack of conformity (which would be accomplished by deleting the words in brackets), the proposed provision could be inserted as a new paragraph (3) of article 19.

Notice of claim for late delivery

4. Sweden (para. 11) suggests that if the seller has not delivered the goods in time and the buyer wishes to claim damages for the delay, he ought to be required to make his claim known within a specified time-limit.

ARTICLE 27

Buyer's right to require cure

1. Yugoslavia (para. 15), the ICC (paras. 32-34) and Sweden (para. 12) comment on the question as to whether the present text of article 27 authorizes the buyer to require the seller to cure any defect in the goods.

(*a*) Yugoslavia assumes that that right does not exist and proposes the inclusion of that portion of article 42 of ULIS which authorized such a requirement. That portion of article 42 reads as follows:

> "1. The buyer may require the seller to perform the contract:
>
> "(*a*) if the sale relates to goods to be produced or manufactured by the seller, by remedying defects in the goods, provided the seller is in a position to remedy the defects;"

(*b*) ICC says it is not clear whether the buyer could require the seller to cure any defect in the goods.

(*c*) Sweden agrees with the statement in paragraph 3 of the commentary to article 27 (A/CN.9/116, annex II; Yearbook . . . , 1976, part two, I, 3) that the present text of article 27 does so authorize the buyer.

(*d*) ICC and Sweden both state that such a right to cure should be contingent upon the possibility that the seller could remedy those defects and that he could do so without unreasonable cost to himself. Sweden suggests that such a clarification might go into article 27 (2).

Substitute goods

2. ICC proposes that the buyer's right to require substitute goods when the lack of conformity constitutes a fundamental breach should be expressly stated to be limited to unascertained (generic) goods, as it is in article 42 (1) (*c*) of ULIS. It should also be stated that the duty to deliver substitute goods falls on the seller only if he can do so without unreasonable efforts or costs to himself.

3. Norway (paras. 24-25) recommends that the time-limit in paragraph (2) for requesting substitute goods be applicable to any request for performance in cases where the seller has made delivery but where the goods do not conform with the contract. Norway proposes the deletion of paragraph (2) and the insertion of the following text:

> "(2) If the seller has made delivery, but the goods do not conform with the contract, the buyer loses his right to require performance, unless such request is made either in conjunction with notice given under article 23 or within a reasonable time thereafter.

"(3) If the goods do not conform with the contract, the buyer may require delivery of substitute goods only where the lack of conformity constitutes a fundamental breach."

See also the Norwegian proposals in respect of article 28.

Non-delivery

4. Sweden (para. 13) states that in a case of non-delivery the buyer should be able to require the seller to deliver the goods only if he presents his request within a reasonable period of time after the last deadline for delivery.

ARTICLE 28

Effect of request for performance on remedies during additional period of time

1. The USSR (para. 8) raises the question whether article 28 should be understood to mean that the penalty provided for in the contract (for example, for delay in delivery) should also be regarded as a remedy to which the buyer cannot resort during the additional period of time provided in this article.

Remedies if performance is made during additional period of time

2. ICC (para. 37) states that article 28 must be understood to mean that if performance follows immediately upon a request, the buyer cannot avoid the contract because of late delivery. However, ICC states, a request for performance could be understood as readiness to receive the goods only if delivery follows promptly.

3. Finland (para. 10), the Federal Republic of Germany (paras. 17-18) and Norway (paras. 26-29) propose that the text should make it clear that the buyer retains his right to exercise the appropriate remedies once the additional period has expired.

(*a*) Finland proposed an additional sentence as follows:

"After the period has expired, the buyer may resort to any remedy which is not inconsistent with performance by the seller on the buyer's request."

(*b*) The Federal Republic of Germany proposes an additional sentence as follows:

"However, the buyer is not deprived of any right he may have to claim damages for delay in the performance."

(*c*) For the proposal of Norway, see the third sentence of the proposal of Norway in the following paragraph of this analysis.

Other proposals

4. Norway states that the main purpose of article 28 is not to provide for a right to request performance, but to regulate the buyer's power to fix an additional period for performance. It states that this purpose should come more in the forefront of the text. Therefore, Norway proposes the following text:

"Subject to the provisions of article 27, the buyer may fix an additional period of time of reasonable length for performance by the seller. During such period the buyer cannot resort to any remedy, unless the seller declares that he will not comply. After the period has expired, the buyer may resort to any remedy which is still open to him and not inconsistent with performance by the seller of the buyer's request."

5. Norway also states that where the buyer does not fix an additional period of time of fixed length, as in its text proposed in paragraph 4 of this analysis, the suspensive effect of the buyer's request for performance should be for a reasonable period of time. However, Norway suggests that such a period of unfixed reasonable time should not have the effect of authorizing the buyer to avoid the contract under article 30 (1) (*b*). To implement these suggestions, Norway proposes modifications to article 30 (see para. 9 of the analysis of article 30) and the following text as a new paragraph (2) to article 28:

"(2) Where the buyer requests the seller to perform, without fixing an additional period referred to in paragraph (1), the request is assumed [, for the purpose of the provisions thereof,] to include the fixing of a period of reasonable length."

6. Sweden (para. 14) notes that article 28 does not apply if "an additional time period of reasonable length" was not stated as part of the request for performance. However, it states, even if no time-limit or a time-limit of less than reasonable length (e.g. "promptly") has been stated, the buyer should not be able to avoid the contract if performance is made either at once or within the period indicated.

Request for cure

7. In its comments on article 30 (1) (*b*) the Federal Republic of Germany (paras. 23-24) proposes that the buyer be given the right to declare the contract avoided if the seller fails to cure a lack of conformity after having been requested to do so under article 28. See paragraph 3 of the analysis of article 30 for the proposed text.

8. For additional proposals in respect of the buyer's right to require the seller to cure a failure of performance, see paragraph 1 of the analysis of article 27. For proposals in respect of the seller's right to cure, see paragraph 1 of the analysis of article 29.

ARTICLE 29

Relationship of cure to other remedies

1. Finland (para. 11) and the Federal Republic of Germany (paras. 20-22) note that the seller's right to cure his failure to perform his obligations is limited to cases where no unreasonable inconvenience or unreasonable cost is caused to the buyer. Finland, therefore, proposes that the seller's right to cure be given priority over the buyer's declaration of avoidance or reduction of the price by deleting that portion of the text after the words "unreasonable expense". On the other hand the Federal Republic of Germany proposes that only the words "or has declared the price to be reduced in accordance with article 31" be deleted. In addition, the Federal Republic of Germany proposes that in article 31 it be made clear that the seller's right to cure failures under article 29 takes precedence over the buyer's right to have the price reduced.

Paragraph (1)

2. As noted in the analysis of article 21, Austria (para. 4) proposes that the drafting of articles 21 and 29 (1) be made identical in respect of the buyer's retention

of any right he might have to claim damages under article 55.

Paragraphs (2) and (3)

3. ICC (para. 38) proposes the deletion of the words in paragraph (2) "or, if no time is indicated, within a reasonable time" and the words "or within a reasonable period of time" in paragraph (3). By this deletion the seller would have an additional period of time within which to perform only if he has requested of the buyer whether he would accept performance during a specified period of time.

4. Sweden (para. 15) suggests that the rule of paragraph (2) should be limited to those cases in which the seller indicates in his request a reasonable time within which he intends to perform. It states that if such an indication is not made, the buyer would sometimes find it so evident that he would not accept the goods that he might not bother to reply.

5. The United States (para. 23 (*e*)) submits a drafting proposal in respect of paragraphs (2) and (3).

ARTICLE 30

Ipso facto *avoidance*

1. Hungary (para. 6), ICC (para. 30) and Yugoslavia (para. 8*a*) state their approval of the deletion of the provisions on *ipso facto* avoidance and their replacement by the rule that avoidance takes place only upon notice given by the party not in breach. Yugoslavia notes that the doctrine of *ipso facto* avoidance could have serious and harmful consequences to the developing countries.

2. The Netherlands (paras. 12-14) notes that the elimination of *ipso facto* avoidance makes for greater clarity in the cases of articles 26, 30 and 62 of ULIS but that *ipso facto* avoidance does not raise as serious difficulties when commercial usage requires the buyer to purchase goods to replace those which the seller has failed to deliver or which do not conform to the contract and it is reasonable for the buyer to do so, or when commercial usage requires the seller to resell the goods and it is reasonable for him to do so. In these two cases articles 25 and 61 of ULIS provide for *ipso facto* avoidance. This has the advantage that one party cannot speculate on the direction in which prices might fluctuate by putting off his decision concerning performance or avoidance in a case where a replacement purchase or resale is in conformity with usage and is possible.

Paragraph (1) (b)

3. The Federal Republic of Germany (paras. 23-24) proposes that the buyer's right to declare the contract avoided should exist also in the case where the seller does not cure a non-conformity of the goods within a reasonable additional period of time as well as when he does not deliver the goods within that period of time. The Federal Republic of Germany notes that in many cases the buyer's interest in the performance of the contract would be infringed by defective delivery just as much as by a failure to deliver at the agreed time. It proposes a text as follows:

> "(*b*) If the seller has been requested to make delivery or to cure a lack of conformity under article 28 and has not complied with the request within the additional period of time fixed by the buyer in accordance with that article or has declared that he will not comply with the request."

4. Bulgaria (para. 6) proposes the deletion of paragraph (1) (*b*), the result of which would be that a contract could be avoided only in the event of a fundamental breach of contract.

5. The Federal Republic of Germany (para. 23) and ICC (para. 39) state that insignificant defects should not give rise to a right to avoid the contract under article 30 (1) (*b*). The Federal Republic of Germany states that this seems to be self-evident and, consequently, to require no express rule. ICC (para. 39) states that if only a part of the goods are missing or a defect has not been remedied within an additional period of time, the situation should come under subparagraph (*a*) and that a fundamental breach should be a prerequisite for avoidance. However, ICC does not state whether it believes such to be the necessary consequences of the current draft or whether it believes that an amendment to the text is called for.

6. Norway (para. 30) proposes a drafting change in article 30 (1) (*b*) to be adopted if its proposals in respect of article 28 are adopted.

Paragraph (2)

7. ICC (para. 40) states its approval of the introduction of the provisions in respect of the loss of the right of avoidance.

8. Bulgaria (para. 6) proposes the simplification of paragraph (2). It states that the buyer should forfeit his right to declare the contract avoided if he has accepted performance which does not conform with the contract without immediately protesting.

9. Norway (para. 31) proposes a drafting change in article 30 (2) (*b*) to be adopted if its proposals in respect of article 28 are adopted. The proposed drafting change would also make reference to article 29. The text as proposed is as follows:

> "(*b*) In respect of any other breach than late delivery, after he knew or ought to have known of such breach, or after the expiration of any additional period of time applicable under articles 28 or 29."

ARTICLE 31

1. Finland (para. 11) and the Federal Republic of Germany (paras. 20-22) state that it should be made clear that the seller's right to cure a failure to perform under article 29 should take precedence over the buyer's right to reduce the price. Both States propose amendments to article 29 to achieve this result. The Federal Republic of Germany suggests that article 31 also be amended to make this result clear but does not propose a specific text.

2. Pakistan (para. 15) suggests that reduction in price should be clearly defined in the contract or be mutually agreed upon thereafter.

3. The United States (para. 23*d*) submits a drafting proposal.

ARTICLE 32

Paragraph (2)

1. The USSR (para. 9) proposes that in paragraph (2) after the words "if the failure to make delivery

completely" the word "and" should be replaced by "and/or" since a fundamental breach of the contract may occur where only one element is present (e.g. failure to make delivery completely, or failure to make delivery in conformity with the contract) and it is not necessary for both to be present.

Proposed paragraph (3)

2. Norway (para. 39) suggests that as an alternative to its proposed amendment of article 48 (2), a new article 32 (3) might be added to the effect that if a buyer avoids a contract in respect of any delivery, there is the possibility of his avoiding the contract as to deliveries already made as well as to future deliveries. See paragraph 2 of the analysis of article 48 for the proposed text.

Chapter IV. Obligations of the buyer

Section I. Payment of the price

ARTICLE 36

1. Pakistan (para. 16) and the USSR (para. 10) state that the price must be determined or determinable. The USSR, therefore, proposes the deletion of this article.

2. ICC (paras. 41-42) proposes that article 36 be amended so that, if a contract has been concluded but does not state the price or expressly or impliedly make provision for its determination, the price to be charged would be the price prevailing at the time of delivery rather than the price prevailing at the time of the conclusion of the contract.

3. The United States (para. 23 (*f*)) submits a drafting proposal.

ARTICLE 39

Paragraph (1)

1. Finland (para. 12) states that the second sentence of paragraph (1) does not seem to add anything to the first sentence and proposes that it be deleted.

Paragraph (2)

2. The United States (para. 23 (*g*)) submits a drafting proposal.

Paragraph (3)

3. Pakistan (para. 16) states that the time-limit during which the goods can be examined must be defined.

ARTICLE 40

The USSR (para. 11) proposes that article 40 read as follows:

> "The buyer must pay the price on the date fixed or determinable by the contract or this Convention without the need for any request or other formality on the part of the seller."

Section II. Taking delivery

Section III. Remedies for breach of contract by the buyer

General observation on section III

The USSR (para. 18) suggests that the possibility be considered of combining the provisions concerning remedies for breach of contract by the seller (chap. III, sect. III) and remedies for breach of contract by the buyer (chap. IV, sect. III).

ARTICLE 42

The USSR (para. 12) states that this article gives rise to the same doubts as does article 26, i.e. that if paragraph (1) is intended to mean that the seller could claim damages in addition to exercising the rights provided in articles 43 and 46, and not as an alternative, then the meaning of paragraph (2) is not clear.

ARTICLE 43

1. The Philippines (para. 10) and the United States (paras. 12-14) suggest that the seller's right to require the buyer to perform his obligations should be limited in certain ways as described in the following paragraphs.

2. The Philippines proposes that the seller be able to require the buyer to perform his obligations only if the seller has already performed his own obligations under the contract. The text of article 43 as proposed by the Philippines is as follows:

> "The seller, after he has duly complied with his obligation under the contract, may require the buyer to pay the price, take delivery or perform any of his other obligations, unless the seller has resorted to a remedy which is inconsistent with such requirement."

3. The United States proposes that the seller be able to require the buyer to perform his obligations, and especially the obligations to pay the price and to take delivery of the goods, only if it is not reasonable for the seller to mitigate any loss resulting from the breach by reselling the goods. The text of article 43 as proposed by the United States is as follows:

> "The seller may require the buyer to pay the price, take delivery or perform any of his other obligations, unless the seller has resorted to a remedy which is inconsistent with such requirement or in the circumstances the seller should reasonably mitigate the loss resulting from the breach by reselling the goods."

4. The United States goes on to suggest an alternative solution which involves a modification of article 59 (see para. 2 of the analysis of article 59). The United States concludes by stating that, if neither of these suggestions was adopted, it would be desirable to limit the action for the price to cases in which the buyer has accepted the goods or the goods have been destroyed or damaged after the risk has passed.

5. Sweden (para. 13) states that when the buyer has not paid the price the seller should be able to require him to do so only if he has made his request within a reasonable period of time after the last deadline for payment.

ARTICLE 44

Proposals and comments similar to those in respect of article 28

1. Finland (para. 13), the Federal Republic of Germany (para. 19) and Norway (para. 32) propose that if their proposals in respect of article 28 are accepted, similar (in the case of Norway) or identical amendments should be made to article 44.

2. The USSR (para. 13) states that article 44 gives rise to the same doubts as article 28, i.e. as to whether this article should be understood to mean that a penalty provided for in the contract (for example, for delay in performance) should also be regarded as a remedy to which the buyer could not resort during the additional period of time provided for in this article.

Proper time-limit not stated

3. Sweden (para. 14) notes that article 44 does not apply if "an additional time period of reasonable length" is not stated as part of the request for performance. However, it states, even if no time-limit or a time-limit of less than reasonable length has been stated (e.g. "promptly"), the seller should not be able to avoid the contract if performance is made either at once or within the period indicated.

4. Norway (para. 32) proposes a new paragraph on the buyer's right to request the seller to make known whether he will accept performance, a provision modelled on article 29. If Norway's proposals noted in paragraph 1 of this analysis were accepted, the new paragraph would be paragraph (3) of this article. The new text as proposed by Norway is as follows:

> "(3) Where the seller has not requested performance, the buyer may request the seller to make known whether he will accept performance. If the seller does not comply within a reasonable time, the buyer may perform within the time indicated in his request, or if no time is indicated, within a reasonable time. The seller cannot, during either period of time, resort to any remedy which is inconsistent with performance by the buyer. A notice by the buyer that he will perform within a specified period of time or within a reasonable time is assumed to include a request under this paragraph that the seller make known his decision."

ARTICLE 45

Ipso facto *avoidance*

1. The comments in respect of *ipso facto* avoidance of Hungary (para. 6), ICC (para. 30) and Yugoslavia (para. 8*a*), which are summarized in paragraph 1 of the analysis to article 30, and of the Netherlands (paras. 12-14), which are summarized in paragraph 2 of the analysis to article 30, apply also to article 45.

Paragraph (1)

2. ICC (paras. 43-45) proposes that article 45 (1) be amended so that once the seller has allowed the buyer to take possession of the goods, he could not take them back from the buyer unless the buyer has failed to pay the price within the additional period set by the seller pursuant to article 44. ICC states that where the buyer has not yet taken delivery of the goods, the rule expressed in the current text of article 45, i.e. that the seller has an immediate right to avoid the contract if there is fundamental breach, is acceptable.

3. Sweden (para. 4) states that if the buyer has paid the price but failed to take delivery, there is no reason why the seller should be able to avoid the contract. It would be enough for the seller to have the possibility of selling the goods on the buyer's account.

Paragraph (1) (b)

4. Bulgaria (para. 6) proposes the deletion of paragraph (1) (*b*), the result of which would be that a contract could be avoided only in the event of a fundamental breach of contract.

5. Norway (para. 32) proposes that, if its suggestion in respect of article 28 is accepted, article 44 should be amended as proposed in paragraph 32 of its comments and that article 45 (1) (*b*) should be amended to conform with the proposed amendment to article 30 (1) (*b*) as set out in paragraph 30 of its comments.

6. The United States (para. 22) notes that in international sales the critical step in the buyer's performance is often not the buyer's actual payment of the price but the establishment of "a letter of credit or a banker's guarantee", as stated in article 35. Therefore the United States proposes that article 45 (1) (*b*) be amended to read as follows:

> "(*b*) if the buyer has been requested under article 44 to pay the price, or to take the necessary steps with respect to payment required under article 35, or to take delivery of the goods, and has not complied with the request within the additional period of time fixed by the seller in accordance with article 44 or has declared that he will not comply with the request."

Paragraph (2)

7. Bulgaria (para. 6) proposes the simplification of article 45 (2). It states that the seller should forfeit his right to declare the contract avoided if he has accepted performance which does not conform with the contract without immediately protesting.

8. ICC (para. 46) proposes that article 45 (2) should be amended so that the seller would have to react to the fact of the buyer's breach within a reasonable period of time after the discovery of the breach and make his choice as to whether he will avoid the contract upon the expiry of an additional period of time set by him or set out a new additional period.

9. Norway (paras. 33-37) suggests that article 45 (2) should distinguish between late payments and other delays in performance. It states that the right of avoidance because of late payment should remain open until the entire payment has been made. However, once the entire payment has been made, it should be too late to declare the contract avoided because of the late payment.

10. Norway also suggests that in respect of any other breach (including delay in taking delivery), the seller should be able to declare the contract avoided even after he has received payment if he has requested performance by the buyer under article 44. This is considered to be preferable to the alternative that once payment had been made, the seller's right to declare the contract avoided is lost no matter what is the nature of the breach.

11. Norway proposes the following text of article 45 (2) to implement these suggestions:

> "(2) However, in cases where the buyer had paid the price the seller loses his right to declare the contract avoided if he has not done so:
>
> "(*a*) in respect of late payment, before the seller has become aware that payment has been made; or
>
> "(*b*) in respect of any other breach than late payment, within a reasonable time after the seller knew

or ought to have known of such breach, or after the expiration of any additional period of time applicable under article 44."

ARTICLE 46

Norway (para. 38) proposes that the last sentence of paragraph (2) should read:

"If the buyer fails to do so after having received the request, the specification made by the seller is binding."

Chapter V. Provisions common to the obligations of the seller and of the buyer

Section I. Anticipatory breach

The United States (para. 16) proposes that the caption to section I of chapter V should be expanded to read: "Section I. Anticipatory breach; instalment contracts". This proposal is made in conjunction with the proposal of the United States in respect of article 48 (1).

ARTICLE 47

Relationship between article 47 and article 49

1. Bulgaria (para. 7) states that the present wording of articles 47 and 49 does not show any clear difference between them. It goes on to state that article 49 seems to be superfluous unless it is included in the form of an addition to article 47.

2. Sweden (para. 16) and ICC (paras. 47-48) on the other hand state that the general rule in article 49, that prior to the date for performance a party can declare the contract avoided only if it is clear that the other party will commit a fundamental breach, should be relied upon rather than the rule in article 47. Sweden states that article 47 should be limited to suspending performance. ICC states that article 47 could be abused by one party requesting security from the other party, e.g. by requesting a letter of credit or a performance guarantee, when such security was not contracted for at the time of the conclusion of the contract. Therefore, it proposes that the last part of paragraph (3) (after the word "thereof" in the first sentence) and every reference to "adequate assurance" be deleted.

Paragraph (1)

3. The United States (para. 23 (*h*)) submits a drafting proposal.

Paragraph (2)

4. Finland (para. 14) proposes that the second sentence of paragraph (2) be deleted as it does not seem to add anything to article 7.

ARTICLE 48

Partial avoidance

1. The United States (para. 15) notes that there is no provision which authorizes the seller to make a partial avoidance of the contract equivalent to the provision in article 32 which allows the buyer to do so. The United States notes that where the buyer's performance is seriously deficient with respect to one instalment, the seller should be permitted to refuse his counter-performance in respect of that instalment even though the failure in respect of that instalment does not give him good reason to fear a fundamental breach in respect of future instalments. Therefore the United States proposes that a new paragraph (1) be added to article 48 and that the current paragraphs (1) and (2) be renumbered as paragraphs (2) and (3). The text as proposed by the United States is as follows:

"(1) In the case of a contract for delivery of goods by instalments, if the failure of one party to perform any of his obligations in respect of any instalment constitutes a fundamental breach with respect to that instalment, the other party may declare the contract avoided with respect to that instalment."

Paragraph (2)

2. Norway (para. 39) proposes that paragraph (2) should be amended, or alternatively a new article 32 (3) should be added, so that if a buyer avoids a contract in respect of any delivery, there is the possibility of his avoiding the contract as to deliveries already made as well as to future deliveries. Norway proposes the following text for paragraph (2):

"(2) If a buyer avoids the contract in respect of any delivery [under a contract for delivery of goods by instalments] and if, by reason of the interdependence with such delivery, other previous or future deliveries cannot be used for the purpose contemplated by the parties in entering into the contract, the buyer may also, provided that he does so at the same time, declare the contract avoided in respect of such previous or future deliveries."

3. The United States (paras. 19, 23 (i)) submits two drafting proposals.

Order of articles 48 and 49

4. Austria (para. 5) proposes that the order of articles 48 and 49 should be reversed for systematic reasons.

ARTICLE 49

1. Bulgaria (para. 7) proposes the deletion of article 49 as being superfluous in the light of article 47.

2. Austria (para. 5) proposes that the order of articles 48 and 49 should be reversed for systematic reasons.

Section II. Exemptions

ARTICLE 50

Article as a whole

1. Hungary (para. 6) states its approval of the text of article 50 while the ICC (para. 49) states that it is a considerable improvement over article 74 of ULIS.

Paragraph (1)

2. Australia (para. 9) states that the proposed Convention does not deal satisfactorily with the problems of non-performance due to causes other than fault on the part of the non-performing party. It states that quite different considerations should apply in the adjustment of rights between the parties to a contract where its performance is impeded by circumstances for which neither party is responsible from those considerations which should apply where one of the parties has by his own

fault been responsible for non-performance or mis-performance and so has caused loss to the other party. In particular it notes (para. 10) that the present provisions are inadequate where there is a temporary impediment to performance. See paragraph 11 of analysis under this article.

3. Austria (paras. 6-7) and the Federal Republic of Germany (paras. 25-26) propose a new text for paragraph 1 which would eliminate any reference to the term "fault" in order to avoid any confusion with the use of the term of "fault" under national laws. The text as proposed by both respondents is as follows:

"(1) If a party has not performed one of his obligations, he is not liable in damages for such non-performance if he proves that it was due to an impediment which he could not reasonably have been expected to take into account or to avoid or to overcome."

Austria also notes that the expression *"de même qualité"* should be deleted from the French version of the text.

4. ICC (paras. 52-53) proposes a redrafting of paragraph (1) so as to eliminate the use of the word "fault" and to use in its place the words "beyond the control of a party". The text as proposed by the ICC is as follows:

"(1) Where a party has not performed one of his obligations he shall not be liable for damages for such non-performance if he proves that it was due to circumstances beyond his control which he could not reasonably have taken into account at the time of the conclusion of the contract and the consequences of which he cannot reasonably be expected to prevail against or to overcome."

5. Norway (para. 40) proposes a redraft of paragraph (1) as follows:

"(1) Where a party has not performed one of his obligations he is not [shall neither be required to perform nor be] liable in damages for such non-performance if he proves that it was due to an impediment beyond his control and of a kind which a party in the same situation could not reasonably be expected neither to take into account at the time of the conclusion of the contract nor to avoid or overcome."

6. The USSR (para. 14) proposes a new text of paragraph (1) as follows:

"(1) If a party has not performed one of his obligations, he is not liable for such non-performance if he proves . . .".

7. The United States (para. 17) states that article 50, while being generally satisfactory, does not sufficiently distinguish between the case of the destruction of specific goods which the parties assumed would be in existence (see example 50A in the commentary, A/CN.9/116, annex II)* and the destruction of goods that the seller planned to use to fulfil the contract (see example 50B in the commentary). The deficiency could be remedied if a requirement is added to article 50 that the non-occurrence of the impediment must have been an implied condition of the parties to the contract. The United States proposes the following revision of article 50 (1), which also contains some drafting suggestions in the second sentence:

"(1) If a party has not performed one of his obligations, he is not liable in damages for such non-performance if he proves that it was due to an impediment which has occurred without fault on his part and whose non-occurrence was an implied condition of the contract. For this purpose there is deemed to be fault unless the non-performing party proves that he 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 after it occurred."

Paragraph (2)

8. The Federal Republic of Germany (paras. 27-28) proposes that paragraph (2) be deleted. It explains that paragraph (2) may constitute an unreasonable hardship for the seller. If the seller is relieved from liability under paragraph (1) for his own failure to perform, his liability for a subcontractor's fault appears to be justified at the most if he can claim and recover indemnity from the subcontractor. Such a claim for indemnity will, however, often fail for reasons of law or of fact, e.g. because of an agreement limiting liability or because of the subcontractor's insolvency.

9. ICC (para. 54) states that the provisions of paragraph (2) seem to correspond to what is frequently practised.

Paragraph (3)

10. The USSR (para. 14) proposes the deletion of paragraph (3).

11. Australia (para. 10), Norway (para. 41) and the United States (para. 24) propose that article 50 should take account of the fact that after there has been a temporary impediment to performance, the performance that would then be required of the party in order to carry out his own obligations under the contract may well be radically different from the performance contemplated when the contract was entered into.

(*a*) Norway proposes the following text:

"(3) The exemption provided by this article has effect for the period during which the impediment existed. However, the party concerned shall be permanently relieved of his liability [obligation] if, when the impediment is removed, the performance has so radically changed as to amount to a performance quite different from that contemplated by the contract."

(*b*) The United States (para. 24) proposes a new text, previously proposed by the United Kingdom during the seventh session of the Working Group on the International Sale of Goods (5-16 January 1976), as follows:

"(3) The provisions of paragraphs (1) and (2) are applicable only for the period during which the impediment existed. However, the non-performing party shall be permanently relieved of his obligation if, when the impediment is removed, the performance has so changed that the contract has become materially more burdensome than had the impediment not occurred."

12. See the comments of ICC, Poland and Sweden discussed in paragraphs 14, 15 and 16 of analysis under this article.

Remedies other than damages

13. ICC (paras. 49-53), Norway (para. 42), Poland (paras. 3-6) and Sweden (paras. 17-19) consider the remedies other than damages available to a party when

* See Yearbook . . ., 1976, part two, I, 3.

the other party does not perform one of his obligations under the contract but that failure is justified under article 50. See also the comments of Australia and the United States discussed in paragraph 11 of analysis under this article.

14. ICC (paras. 49-53) states that the current text is adequate in this respect and that article 50 should not be amended to contain any provisions granting final relief from the obligations under the contract on the grounds that performance has become impossible or that the conditions have changed so radically that performance would amount to performance of a different contract. The party who wishes to avoid the contract could rely on article 30 or 45, as the case may be, of the present text.

15. Poland (paras. 3-6) suggests that the proposed Convention should include a provision dealing with the principle *rebus sic stantibus* according to which any party has a right to renegotiate the conditions of a contract or to call for its termination. Therefore, Poland proposes to have the following added at the end of article 50:

> "If, as a result of special events which occurred after the conclusion of the contract and which could not have been foreseen by the parties, the performance of its stipulations results in excessive difficulties or threatens either party with considerable damage, any party so affected has a right to claim an adequate amendment of the contract or its termination."

16. (*a*) Sweden (paras. 17-19) notes that the exemption from liability for damages may become worthless where the other party can force performance. Therefore, the duty to perform should also be exempted during the period of the impediment. After the impediment is removed, the party seeking performance should be required to request it. Should the impediment last a long time, the Convention should indicate that the obligation to perform ceases entirely.

(*b*) Sweden also suggests that the right to avoid the contract or to reduce the price should not be affected by article 50.

17. Norway (para. 42) suggests that article 50 should be amended to make it clear that the provisions on price reduction and avoidance of the contract are not affected by article 50 and, to implement this suggestion, proposes a new paragraph (5) as follows:

> "(5) Nothing in this article prevents a party from avoiding the contract or reducing the price in accordance with the provisions of this Convention on account of a failure by the other party to perform any of his obligations."

Section III. Effects of avoidance

Proposed article on effects of avoidance

Austria (para. 8) proposes to add a new article before article 51 in which the obligation to pay damages is stated fundamentally, in a way similar to the "exemption" in article 50.

ARTICLE 54

Paragraph (2)

Austria (para. 9) suggests that the buyer ought to be bound to account to the seller not only for all benefits which he has derived from the goods or part of them, but also for all benefits which he reasonably could have derived from them.

Section IV. Damages

Relationship between articles 55, 56 and 57

1. Australia (para. 11), Norway (paras. 43-49) and the USSR (paras. 15-16) comment on the relationship between articles 55, 56 and 57.

2. Australia and Norway state that the claimant should not be entitled to choose the damage formula in articles 55, 56 or 57 which is the most favourable to him in the particular case. They state that articles 56 and 57 should serve as illustrations of the operation of article 55 in particular circumstances.

3. In order to eliminate the possibility that the claimant could choose a damage formula which would give him a recovery in excess of his loss as measured by the difference in price as actually established, Norway proposes (see especially para. 48) that the reference to article 55 which is currently found in articles 56 (1) and 57 (1) should be deleted. It notes (para. 47), however, that other items of loss would continue to be governed by the rules of article 55 read in conjunction with article 59.

4. As an alternative, Norway (para. 49) proposes that article 56 (1) be amended by deleting the words "if he does not rely upon the provisions of articles 55 or 57" and substituting the words "as part of the damages referred to in article 55". If this proposal is adopted, article 56 (2) should be deleted as superfluous. Norway further notes that the claimant's option to invoke either article 56 or article 57 would follow from the wording in article 57.

5. The USSR (paras. 15-16) proposes that both article 56 (2) and article 57 (3) be amended to read as follows:

> "The provisions of paragraph (1) of this article do not preclude the right to seek other damages also, if the conditions of article 55 are satisfied."

The USSR notes that this proposal is prompted by a desire to avoid a direct reference to loss of profit since, in the first place, it is already referred to in article 55, where it is stated that damages are understood to cover loss of profit, and, in the second place, in such a situation it is difficult to imagine the loss of profit over and above the difference in prices.

ARTICLE 55

Foreseeability of loss

1. ICC (para. 56) expresses its doubts whether the limitation on the amount of damages which a claimant could recover to an amount no greater than "the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract" would be equitable in a number of circumstances. ICC suggests that consideration might be given to the deletion of this restriction in the last sentence of article 55 and to relying on a provision of a more general nature. However, it notes that deletion of any limitation of the loss for which one party has to compensate the other would not be advisable.

Damages in case of fraud

2. Norway (paras. 52-53) proposes the addition of a new article regulating the effect of fraud in the performance of the contract on the damages which could be recovered. This proposal is noted below following the analysis of article 59.[6]

ARTICLE 56

Paragraph (1)

1. Norway (paras. 43-49) proposes that the reference to article 55 be deleted from article 56 (1), as described in paragraph 3 of the analysis under section IV (Damages) above. As an alternative Norway proposes an amended text of article 56 (1), as described in paragraph 4 of that same analysis.

Paragraph (2)

2. The USSR (para. 15) proposes an amended text of article 56 (2), as described in paragraph 5 of the analysis under section IV (Damages) above.

3. If the Norwegian alternative proposal noted in paragraph 1 of this analysis is adopted, Norway (para. 49) proposes that article 56 (2) be deleted as superfluous.

ARTICLE 57

Paragraph (1)

1. Austria (para. 10) suggests that damages under this provision should be based on the current price on the date delivery is performed or should be performed while Bulgaria (para. 9) suggests that they should be based on the current price at the time of the failure to deliver the goods or at the time when the buyer could reasonably procure the same goods. Both Austria and Bulgaria state that the current wording of article 57 (1) allows a party to speculate on price changes by delaying the date on which he declares the contract avoided.

2. Norway (paras. 43-49) proposes that the reference to article 55 be deleted from article 57 (1), as described in paragraph 3 of the analysis under section IV (Damages) above.

Paragraph (2)

3. Pakistan (para. 17) notes that in calculating the amount of damages, "invoice value" should preferably be the basis.

Paragraph (3)

4. The USSR (para. 16) proposes an amended text of article 57 (3), as described in paragraph 5 of the analysis under section IV (Damages) above.

ARTICLE 58

Rate of interest

1. The Federal Republic of Germany (paras. 29-30) is of the view that the seller should not be able to claim such a high interest rate in every case of delay in payment of the purchase price, but only if he is actually compelled to take a loan at such a rate of interest. Furthermore, interest rates for unsecured short-term credits vary greatly depending on such factors as the customer's credit-worthiness. It proposes the deletion of the following words at the end of article 58:

> "but his entitlement is not to be lower than the rate applied to unsecured short-term commercial credits in the country where the seller has his place of business."

2. ICC (para. 57) suggests that the surcharge over the official discount rate which the seller might recover be increased from 1 per cent to at least 2 per cent.

ARTICLE 59

Mitigation by choosing remedy

1. In conjunction with its discussion of articles 55, 56 and 57, Norway (para. 43) notes that paragraph 4 of the commentary to article 56 (A/CN.9/116, annex II; Yearbook . . . , 1976, part two, I, 3) and paragraph 3 of the commentary on article 59 state that article 59 does not require the injured party to choose the remedy which would be the least expensive to the party in breach or the formula for the calculation of damages under article 55, 56 or 57 which would result in the lowest amount of damages. Norway states that, without admitting the correctness of this interpretation of these articles, the strong emphasis on the free choice of the claimant in the present text of articles 56 (1) and 57 (1) may permit an interpretation of article 59 which will reduce the duty of the claimant to mitigate the loss far beyond what is today the law in many countries. It therefore proposes amendments to articles 56 and 57 to eliminate this possible interpretation. The proposals are discussed in paragraphs 3 and 4 of the analysis under section IV (Damages) above.

Right to recover the price

2. The United States (paras. 12-14) makes alternative proposals in respect of articles 43 and 59. Its primary proposal (see paragraphs 3 and 4 of the analysis of article 43) is that article 43 be amended so that the seller could not require the buyer to pay the price if "in the circumstances the seller should reasonably mitigate the loss resulting from the breach by reselling the goods". However, if that proposal is not accepted, the United States proposes that the second sentence of article 59 be amended to read as follows:

> "If he fails to adopt such measures, the party in breach may claim a reduction in the damages, including any claim for the price, in the amount which should have been mitigated."

Duty to notify

3. Norway (para. 50) suggests that as part of the duty to mitigate the injured party should give notice of the breach to the party in breach, within a reasonable time. It is stated that this is of practical importance in cases where the party in breach may otherwise be unaware of the breach or the consequences thereof or may be in a better position to take measures to mitigate the loss. Therefore, Norway proposes the following addition to article 59:

> "These measures shall include, where appropriate, notice within a reasonable time to the party in breach for the purpose of enabling him to mitigate the loss."

[6] The similar provision in ULIS, i.e. article 89, has the effect, in particular, of restricting the application of that portion of article 82 of ULIS (equivalent to article 55 of the present text) which limits the damages which could be recovered to those which are foreseen or foreseeable by the party in breach.

Proposed new article on fraud

Norway (paras. 52-53) notes that article 89 of ULIS, which provides that in case of fraud, the determination of damages is to be made by reference to national law, has been deleted. Norway proposes that this decision should be reconsidered and that the draft Convention should regulate the effect of fraud in the performance of the contract on the damages which could be recovered.

Proposed new article on penalties

Poland (paras. 10-11) proposes that a new article be included in the draft Convention which would govern penalty clauses in a contract. It states that such a provision would facilitate, to a considerable degree, any claim of damages for breach of contract. Regulation of the question of penalties would also eliminate the existing lack of uniformity in this field in the various legal systems.

Section V. Presentation of the goods

ARTICLE 63

1. Pakistan (para. 18) states that it is reasonable to determine a time limit within which the notice required by paragraph (1) could be given and that the other party should be duly intimated. It also states that the preservation cost referred to in paragraph (3) should be intimated to the buyer by the seller.

2. The United States (para. 23 (*j*)) submits a drafting proposal in respect of paragraph (1).

Chapter VI. Passing of risk

ARTICLE 64

Article as a whole

1. Bulgaria (para. 10) suggests placing this article before the other articles of chapter VI, since it states the general rule for the passing of risk.

2. Austria (para. 11) states that this article should make it clear that only an act of the seller done before the handing over of the goods can be taken into account in determining whether loss or damage to the goods excuses the buyer from paying the price.

Delivery and passage of risk

3. Sweden (para. 10) states that it is difficult to see why different conditions for delivery and for passage of risk have been laid down and suggests that it should be possible to co-ordinate the rules further.

ARTICLE 65

Paragraph (1)

1. The Federal Republic of Germany (para. 31) states that article 65 (1) does not give a reasonable solution to the case where the seller undertakes to ship the goods from a particular place. For instance, in a situation in which a seller who has his place of business at an inland point contracts to provide for shipment of the goods from a particular seaport, the risk should pass when the goods are handed over to the sea carrier and not when they are handed over to the first carrier who carries them to the seaport. It therefore proposes that the following sentence be added to paragraph (1):

> "However, if the seller is required to hand the goods over to the carrier at a particular place, the risk does not pass to the buyer before the goods are handed over to the carrier at this place."

2. Bulgaria (para. 8) suggests that a provision should be added to article 65 (1) (and to article 15 (*a*)) to the effect that delivery is made and the risk thus passes when the goods are handed to the first carrier, a rule which it says would reflect international commercial practice.

3. The United States (para. 18) suggests that article 65 (1) should be made clearer in two respects. It should be made clear that article 65 (1) does not lead by negative implication to the result that the risk of loss in CIF or C and F contracts passes at destination rather than at the time the goods are handed over to the carrier. It should also be made clear that the seller's retention of control of the goods through taking a bill of lading does not derogate from the usual rules on risk of loss. The proposal of the United States, as set out below, also deletes the words "when the goods are handed over to the first carrier" and substitutes the words "when the goods are handed over to a carrier". The text of article 65 (1) as proposed by the United States is as follows:

> "(1) If the contract of sale involves carriage of goods and the seller is not required to hand the goods over to the buyer at a particular destination, the risk passes to the buyer when the goods are handed over to a carrier for transmission to the buyer. The fact that the seller is authorized to retain documents controlling the disposition of the goods does not affect the passage of risk."

Paragraph (2)

4. Austria (para. 12) suggests that paragraph (2) should be amended in order to make it clear that in sales involving carriage of the goods, as well as in other sales, the risk passes to a buyer no earlier than at the moment of the conclusion of the contract.

5. Norway (para. 54) states that the risk in respect of goods sold in transit should not pass on shipment if the shipment is of unascertained or unidentified goods in bulk transmission to different consignees.[7] It therefore proposes that paragraph (2) read as follows:

> "(2) Where the contract of sale relates to goods already in transit, the risk is borne by the buyer as from the time when such goods were handed over to the first carrier for transmission to the seller or another consignee. However, the risk of loss of goods sold in transit does not pass to the buyer if, at the time of the conclusion of the contract, the seller knew or ought to have known that the goods [or part thereof] had been lost or damaged, unless the seller discloses such fact to the buyer."

Proposed paragraph (3)

6. Norway (para. 55) proposes that a new paragraph (3) be adopted as previously proposed by it in the

[7] Norway makes no such proposal in respect of article 65 (1). That the risk does not pass on shipment under article 65 (1) if the shipment is of unascertained or unidentified goods in bulk transmission to different consignees, see para. 5 of the commentary to article 65, A/CN.9/116, annex II (Yearbook..., 1976, part two, I, 3).

Working Group on the International Sale of Goods (A/CN.9/WG.2/WP.25, article 67). That proposal reads as follows:

"(3) Nevertheless, if the goods are not marked with an address or otherwise clearly identified for delivery to the buyer, the risk shall not pass until the seller has given notice of the consignment and, if necessary, sent some document specifying the goods."

7. For similar proposals in respect of article 66, see paragraphs 6-9 of the analysis under article 66.

ARTICLE 66

Paragraph (1)

1. Bulgaria (para. 5) and the Netherlands (paras. 15-16) propose that the rule in article 97 (1) of ULIS, i.e. that the risk passes to the buyer when delivery of the goods is effected in accordance with the provisions of the contract and of the Uniform Law, should be reinstated.

(*a*) Bulgaria goes on to say that, in line with its recommendations in respect of article 15, described in paragraph 4 of the analysis of article 15, delivery and the passage of the risk should take place only when the goods are handed over to the buyer rather than when they are placed at his disposal.

(*b*) The Netherlands states that the risk should not pass if the goods are not in conformity with the contract unless, as in article 97 (2) of ULIS, the buyer has neither declared the contract avoided nor required goods in replacement.

2. Norway (paras. 56-60) proposes a complete redraft of article 66, the full text of which is set out below in paragraph 9 of this analysis. As to the current paragraph (1), Norway proposes, *inter alia*, the deletion of the words "as from the time when the goods were placed at his disposal" to make it clear that the risk passes when the goods are taken over by the buyer. (See also paragraph 4, below.)

3. ICC (paras. 19-20) proposes on the other hand that article 66 (1) should be amended to provide that where the delivery term of the contract calls for the seller to place the goods at the disposal of the buyer during a specified period of time, the risk of loss should pass at the time the goods are placed at the buyer's disposal and not when they are taken over by him (article 66 (1)) or when the buyer is in breach for having failed to take them over (article 66 (2)). ICC states that such a rule, which is similar to that found in the Incoterm definition of "ex works", would reflect commercial practice.

Paragraph (2)

4. In its complete redrafting of article 66, Norway (paras. 56 and 57) proposes that the first sentence of paragraph (2) be consolidated with the current paragraph (1) in a new paragraph (1).

5. Norway (paras. 56, 58-59) also proposes that a new paragraph (2) be adopted which would govern the time at which the risk passes where the goods are at a place other than a place of business of the seller, such as a public warehouse. Norway notes that it has been suggested that the buyer "takes over" the goods when an appropriate act has occurred after which the third person is responsible to the buyer for the goods (and that the risk in such cases passes even before the buyer has committed a breach of contract by failing to take over the goods physically).[8] Norway further notes that it has been submitted that such an appropriate act includes the handing over of a negotiable document of title (e.g. a negotiable warehouse receipt) or the acknowledgement by the third person that he holds the goods for the benefit of the buyer. While Norway considers this interpretation not to be justified by the current text and one which would bring about uncertainties in applying the concept of "take over", it states that the problem calls for a clear provision. The text proposed by Norway is set out as paragraph (2) of its proposed redraft of article 66.

Paragraphs (2) and (3). Identifying goods to the contract

6. Norway (paras. 56 and 60) also proposes that the second sentence of the current paragraph (2) be restated, with a drafting change, as a new paragraph (3).

7. The United States (para. 25) proposes that a new paragraph (3) be added which would read as follows:

"(3) If the goods are not identified for delivery to the buyer, by marking with an address or otherwise, they are not clearly identified to the contract, unless the seller gives notice of the consignment and, if necessary, sends some documents specifying the goods."

The United States notes that its proposal is based upon one previously made by Norway during the seventh session of the Working Group on the International Sale of Goods.

8. For a similar proposal in respect of article 65, see paragraph 6 of the analysis under article 65.

Text proposed by Norway

9. The complete text of article 66 as proposed by Norway (para. 56) is as follows:

"(1) In cases not covered by article 65 the risk passes to the buyer when the goods are taken over by him or, where he has not done so in due time, from earlier moment when the goods have been placed at his disposal and he has committed a breach of contract by failing to take delivery.

"(2) If, however, the buyer is required to take over the goods at a place other than any place of the seller, the risk passes when the time for delivery has come and the buyer is aware, or has received notice, of the fact that the goods are placed at his disposal at such place.

"(3) Where the contract relates to a sale of goods not then identified, the goods are deemed not to be placed at the disposal of the buyer until they have been separated or otherwise clearly identified to the contract."

ARTICLE 67

The comments of the Netherlands (paras. 15-16) as described in paragraph 1 of the analysis under article 66 are also directed at article 67.

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[8] See para. 2 of the commentary to article 66, A/CN.9/116, annex II (Yearbook . . . , 1976, part two, I, 3).

F. Report of the Secretary-General: draft convention on the international sale of goods; draft articles concerning implementation and other final clauses (A/CN.9/135)*

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INTRODUCTION

1. At the seventh session (5-16 January 1976) of the Working Group on the International Sale of Goods, at which the text of the draft Convention on the International Sale of Goods was approved, the Working Group requested the Secretariat to prepare draft provisions relating to implementation of the proposed Convention and draft final clauses for consideration of the Commission at a future session.[1] The present report has been prepared in response to that request.

2. Each draft article is accompanied by a brief commentary to facilitate consideration of the draft articles by the Commission.

DRAFT ARTICLES

Article [1]. Depositary

The Secretary-General of the United Nations is hereby designated as the depositary of this Convention.

Prior conventions or draft articles

Convention on the Limitation Period in the International Sale of Goods, articles 31(2), 40, 41, 42, 43, 44, 45 and 46.

Draft Convention on the Carriage of Goods by Sea, A/CN.9/115.[2]

Commentary

1. Throughout the remainder of these draft articles the Secretary-General of the United Nations is referred to as "the depositary" without repetition of his title.

2. The general functions of a depositary are described in article 77 of the Vienna Convention on the Law of Treaties. Additional functions of the depositary of this Convention are set out in article [7] of these draft articles.

3. This text is identical to that proposed for the draft Convention on the Carriage of Goods by Sea. It differs from some other conventions which state the individual or entity who is to serve as depositary in the same article as that which specifies the official languages. In this respect, compare article [9] of these draft articles with article 46 of the Convention on the Limitation Period.

Article [2]. Federal-State clause

Commentary

1. Some conventions for the unification of private law contain a federal-State clause and such a clause may be thought to be desirable for this Convention. Federal-State clauses have been intended either (i) to specify the obligation of the federal government of a contracting State where the subject-matter of the convention was such that the constituent States, provinces or cantons of the federation had legislative jurisdiction, or (ii) to authorize a contracting State in which there are two or more different systems of law in respect of the subject-matter in question to declare that the convention would apply to only a portion of the territory of that State.

2. Appendix I to this article reproduces article 11 of the Convention on the Recovery Abroad of Maintenance concluded at New York on 20 June 1956, which is a federal-State clause of the first type, and appendix II reproduces article 31 of the Convention on the Limitation Period, which is a federal-State clause of the second type.

3. At the Conference on Prescription many States found both of the formulations unacceptable.[3] The representative of one federal State insisted that article 31 of the Convention on the Limitation Period should not become a precedent.[4] Moreover, at the ninth session of

* 15 April 1977.

[1] See the report of the Working Group on the International Sale of Goods on the work of its seventh session, A/CN.9/116, para. 11 (Yearbook ..., 1976, part two, I, 3).

[2] A revised version of the draft articles concerning application, reservations and other final clauses in respect of the draft Convention on the Carriage of Goods by Sea as found in A/CN.9/115 will be presented to the Conference of Plenipotentiaries which has been convened to adopt the Convention. That revised version is contained in document A/CONF.89/6.

[3] Report of the Second Committee, paras. 14-19, summary records of plenary meetings, 9th meeting, paras. 52-61; summary records of Second Committee, 1st meeting, paras. 14-25; 2nd meeting, paras. 8-9; 3rd meeting, paras. 1-3; 4th meeting, paras. 1-43. (*Official Records of the United Nations Commission on Prescription (Limitation) in the International Sale of Goods;* United Nations publication, Sales No. 74.V.8: hereafter referred to as Official Records.)

[4] Summary records of plenary meetings, 9th meeting, para. 53 (Australia).

the Commission, during the consideration of the draft Convention on the Carriage of Goods by Sea, the representative of one State with a federal system of government (United States) expressed the view that a federal-State clause based on article 31 of the Convention on the Limitation Period was unnecessary and the representative of another federal State (Australia) considered that such a provision would cause difficulties under the constitution of his country.[5]

4. In the light of these considerations the Commission may wish to request the Secretary-General to invite federal and non-unitary States to indicate their views on the desirability of a federal-State clause in the Convention on the International Sale of Goods. The Commission may also wish to request the Secretary-General on the basis of these views to prepare a new draft of a federal-State clause.

Appendix I

Convention on the Recovery Abroad of Maintenance

Article 11. Federal State clause

In the case of a federal or non-unitary State, the following provisions shall apply:

(*a*) With respect to those articles of this Convention that come within the legislative jurisdiction to the federal legislative authority, the obligations of the federal government shall to this extent be the same as those of Parties which are not federal States;

(*b*) With respect to those articles of this Convention that come within the legislative jurisdiction of constituent States, provinces or cantons which are not, under the constitutional system of the federation, bound to take legislative action, the federal government shall bring such articles with a favourable recommendation to the notice of the appropriate authorities of States, provinces or cantons at the earliest possible moment;

(*c*) A federal State party to this Convention shall, at the request of any other Contracting Party transmitted through the Secretary-General, supply a statement of the law and practice of the federation and its constituent units in regard to any particular provision of the Convention, showing the extent to which effect has been given to that provision by legislative or other action.

Appendix II

Convention on the Limitation Period in the International Sale of Goods

Article 31

1. If a Contracting State has two or more territorial units in which, according to its constitution, different systems of law are applicable in relation to the matters dealt with in this Convention, it may, at the time of signature, ratification or accession, declare that this Convention shall extend to all its territorial units or only to one or more of them, and may amend its declaration by submitting another declaration at any time.

2. These declarations shall be notified to the Secretary-General of the United Nations and shall state expressly the territorial units to which the Convention applies.

3. If a Contracting State described in paragraph (1) of this article makes no declaration at the time of signature, ratification or accession, the Convention shall have effect within all territorial units of that State.

[5] A/31/17, annex I, draft provisions concerning implementation, reservations and other final clauses, para. 5 (Yearbook ..., 1976, part one, II, (A).

Article [3]. Declaration of non-application of Convention

Two or more Contracting States may at any time declare [, either jointly or by reciprocal unilateral declarations,] that contracts of sale between a seller having a place of business in one of these States and a buyer having a place of business in another of these States shall not be governed by this Convention, because they apply to the matters governed by this Convention the same or closely related legal rules.

Prior conventions or draft articles

Convention on the Limitation Period, article 34.

Convention Relating to a Uniform Law on the International Sale of Goods, done at The Hague, 1 July 1964,[6] article II, paragraph 1.

Commentary

1. Article [3] enables two or more States to preclude the application of the present Convention to contracts to which it would otherwise have applied "because they apply to the matters governed by this Convention the same or closely related legal rules".

2. It is not clear whether article 31 of the Convention on the Limitation Period requires the declaration to be a joint declaration of the two or more States or whether the States concerned can make unilateral declarations which refer to or anticipate one another. However, it is clear from article 40(2) of that Convention, repeated in article [4(7)] of the present draft articles, that withdrawal of the declaration may be made unilaterally, which would suggest that it should be possible to make the declaration unilaterally. Therefore, the words "either jointly or by reciprocal unilateral declarations" have been inserted in brackets to make it clear that the declarations may be in either form.

Article [4]. Declaration under article [2] or [3]

(1) Declarations made under article [2] or [3] at the time of signature are subject to confirmation upon ratification [, acceptance or approval].

(2) Declarations, and the confirmation of declarations, must be in writing and must be formally notified to the depositary.

[(3) Declarations made under article [2] must state expressly the territorial units to which the Convention applies.]

[(4) If a Contracting State described in article [2] makes no declaration at the time of signature, ratification [, acceptance, approval] or accession, the Convention has effect within all territorial units of that State.]

(5) Declarations take effect simultaneously with the entry into force of this Convention in respect of the State concerned, except for declarations of which the depositary receives formal notification after such entry into force. The latter declarations shall take effect on the first day of the month following the expiration of six months after the date of their receipt by the depositary [except that reciprocal unilateral declarations under article [3] shall take effect on the first day of the month

[6] Hereafter referred to as the 1964 Hague Convention.

following the expiration of six months after the receipt of the latest declaration by the depositary].

(6) Any State which has made a declaration under this Convention may withdraw it at any time by means of a formal notification in writing addressed to the depositary. Such withdrawal takes effect on the first day of the month following the expiration of six months after the date of the receipt of the notification by the depositary.

(7) In the case of a withdrawal of a declaration made under article [3] of this Convention, such withdrawal also renders inoperative, as from the date on which the withdrawal takes effect, any reciprocal declaration made by another State under that article.

Prior conventions and draft articles

Convention on the Limitation Period, articles 31 (2), (3) and 40.

Draft Convention on the Carriage of Goods by Sea, A/CN.9/115.[7]

Commentary

1. Article [4] defines the manner of making declarations under articles 2 or 3 of the present Convention, the manner of their withdrawal[8] and the time at which a declaration or a withdrawal of a declaration becomes effective.

Declarations and other confirmation, paragraphs (1) and (2)

2. These provisions ensure that all declarations are formally notified to the depositary.[9]

Declarations under article [2] (federal-State clause), paragraphs (3) and (4)

3. Paragraphs (3) and (4) implement a federal-State clause of the type found in appendix II to article [2] of these draft provisions. If no provision similar in nature to that clause is adopted, paragraphs (3) and (4) of this article should be deleted.

Entry into effect of declarations, and withdrawals of declarations, paragraphs (5) and (6)

4. Paragraphs (5) and (6) state the same rules as are found in article 40 of the Convention on the Limitation Period.

Withdrawal pursuant to article [3] (declaration of non-application of Convention), paragraph (7)

5. This provision is based on the last sentence of article 40(2) of the Convention on the Limitation Period.

6. Paragraph (7) provides for unilateral withdrawal of a declaration made under article [3] whether or not article [3] as adopted requires a joint declaration or permits reciprocal unilateral declarations.

7. If no provision similar in nature to that found in appendix II to article [2] of these draft provisions is adopted, paragraphs (6) and (7) could easily be consolidated since the only declarations permissible would be those made under article [3].

Article [5]. Date of application

Alternative A. The provisions of this Convention apply to contracts which, at the time they were concluded were subject to this Convention by virtue of article 1 or article 4.

Alternative B. Delete article 4 of this Convention and amend article 1(1) to read as follows:

"(1) This Convention applies to contracts of sale of goods entered into by parties whose places of business are in different States if at the time of the conclusion of the contract:

"(*a*) the States were Contracting Parties; or

"(*b*) the rules of private international law led to the application of the law of a Contracting Party; or

"(*c*) the parties had chosen this Convention as the law of the contract".

Prior conventions or draft articles

Convention on the Limitation Period, articles 2(*a*), 3 and 33.

Commentary

1. Article [5] defines the point of time from which the provisions of this Convention apply to contracts falling within the sphere of application of the Convention.

2. Alternatives A and B are intended to achieve the same result. Alternative A deals with the question of date of application of the Convention in the context of these final clauses. Alternative B deals with the problem by incorporating the date of application into article 1 of the draft Convention, the article which contains the provisions on the sphere of application of the Convention.

3. Both alternatives are designed to provide for the date of application of the Convention in relation to all three ways in which the Convention is attracted to a contract as set out in articles 1 and 4 of the draft Convention. In order to facilitate the drafting of this provision, in alternative B article 4 was deleted and its substance was combined with article 1.

Article [6]. Signature, ratification, [acceptance, approval,] accession

(1) This Convention is open for signature by all States until . . . inclusive at the Headquarters of the United Nations, New York.

(2) This Convention is subject to ratification [, acceptance or approval] by the signatory States.

(3) This Convention shall be open for accession by all States which are not signatory States.

(4) Instruments of ratification [, acceptance, approval] and accession shall be deposited with the depositary.

Prior conventions and draft articles

Convention on the Limitation Period, articles 41, 42 and 43.

[7] See foot-note 1 above.

[8] Article 31(1) of the Convention on the Limitation Period and alternative A of article [2] contain a procedure for the amendment of declarations made pursuant to those articles by submitting another declaration.

[9] Article 77, para. (1) (*e*) of the Vienna Convention on Treaties provides that the functions of a depositary, unless provided otherwise comprise (*inter alia*) "Informing the parties and the States entitled to become parties to the treaty of acts, notifications and communications relating to the treaty".

Draft Convention on the Carriage of Goods by Sea, A/CN.9/115.[10]

Commentary

1. Article [6] sets out the manner in which States may become parties to the Convention.

2. This article follows articles 41, 42 and 43 of the Convention on the Limitation Period except that:

(*a*) These provisions are gathered together in one article for reasons of ease of reference; and

(*b*) Signatures are subject to ratification, acceptance or approval instead of merely subject to ratification.

3. The addition of acceptance and approval as means whereby the consent of a State to be bound by the Convention accords with modern methods of treaty-making practice as set out in articles 11 to 16 of the Vienna Convention on the Law of Treaties.[11]

Article [7]. *Entry into force*

(1) This Convention enters into force on the first day of the month following the expiration of [thirteen] months after the date of the deposit of the [tenth] instrument of ratificaton [, acceptance, approval] or accession.

(2) For each State ratifying or acceding to this Convention after the deposit of the [tenth] instrument of ratification [, acceptance, approval] or accession, this Convention enters into force in respect of that State on the first day of the month following the expiration of [thirteen] months after the date of the deposit of its instrument of ratification or accession.

(3) A State which ratifies [, accepts, approves] or accedes to this Convention and is a Party to the Convention relating to a Uniform Law on the International Sale of Goods done at The Hague on 1 July 1964 (1964 Hague Convention) shall at the same time denounce that Convention by notifying the Government of the Netherlands to that effect, such denunciation to be effective on the date this Convention enters into force in respect of that State.

(4) Upon the deposit of the [tenth] instrument of ratification [, acceptance, approval] or accession, the depositary shall inform the Government of the Netherlands as the depositary of the 1964 Hague Convention of the date on which this Convention will enter into force and of the names of the Contracting States to this Convention as of that date.

Prior conventions and draft articles

Convention on the Limitation Period, article 44.

1964 Hague Convention, article X.

Commentary

1. Article [7] defines the date on which this Convention enters into force and deals with its relationship to the 1964 Hague Convention.

Entry into force of Convention paragraph (1)

2. This provision is almost identical to article 44 of the Convention on the Limitation Period except that this Convention does not enter into force until 13 months after the date of deposit of the [tenth] instrument of ratification [, acceptance, approval] or accession rather than the six-month period selected in the Convention on the Limitation Period. That period of six months was chosen to give Governments which became party to the Convention on the Limitation Period sufficient time to notify all the national organizations and individuals concerned that a Convention which would affect them would soon enter into force.[12]

3. However, the period of 13 months is suggested in respect of the proposed Convention on the International Sale of Goods to allow sufficient time for denunciations of the 1964 Hague Convention to take effect on the same date as this Convention would enter into force in respect of any State which is a Party to the 1964 Hague Convention. That Convention provides that denunciations are effective 12 months after receipt by the Government of the Netherlands.[13] The additional one month is to allow adequate time for the Government of the Netherlands to be notified of the denunciation, as provided for in paragraph (3) of this article.

4. The number of instruments of ratification required to bring the Convention on the Limitation Period into force is 10.[14]

5. However, the Commission may think that it should not be necessary for that number of States to ratify a convention on a private law matter to bring it into force. It might be noted that the 1964 Hague Convention came into force by virtue of five ratifications or accessions and the Inter-American Convention on International Commercial Arbitration done at Panama City on 30 January 1975 requires only two ratifications. Accordingly, the word "tenth" has been placed in square brackets in paragraphs (1), (2) and (4) of this article.

[10] See foot-note 1 above.

[11] The International Law Commission has described the reasons for the introduction of acceptance and approval into treaty-making practice as follows:

"(11) 'Signature subject to acceptance' was introduced into treaty practice principally in order to provide a simplified form of 'ratification' which would allow the government a further opportunity to examine the treaty when it is not necessarily obliged to submit it to the State's constitutional procedure for obtaining ratification. Accordingly, the procedure of 'signature subject to acceptance' is employed more particularly in the case of treaties whose form or subject-matter is not such as would normally bring them under the constitutional requirements of parliamentary 'ratification' in force in many States. In some cases, in order to make it as easy as possible for States with their varying constitutional requirements to enter into the treaty, its terms provide for either ratification or acceptance. Nevertheless, it remains broadly true that 'acceptance' is generally used as a simplified procedure of 'ratification'.

"(12) The observations in the preceding paragraph apply *mutatis mutandis* to 'approval', whose introduction into the terminology of treaty-making is even more recent than that of 'acceptance'. 'Approval', perhaps, appears more often in the form of 'signature subject to approval' than in the form of a treaty which is simply made open to 'approval' without signature. But it appears in both forms. Its introduction into treaty-making practice seems, in fact, to have been inspired by the constitutional procedures or practices of approving treaties which exist in some countries."

(Draft articles on the law of treaties with commentaries, adopted by the International Law Commission at its eighteenth session, commentary on draft article 11; *Official Records of the United Nations Conference on the Law of Treaties*, documents of the Conference, part B (United Nations publication, Sales No. 70.V.5).)

[12] Summary records of Second Committee, 1st meeting, paras. 45-50, (Official Records, part two).

[13] Article XII, para. 2.

[14] Article 44, para. 1.

Entry into force of Convention in respect of States ratifying or acceding to Convention after it has entered into force, paragraph (2)

6. Paragraph (2) of article [7] is closely modelled on paragraph (2) of article 44 of the Convention on the Limitation Period except that, as in paragraph (1), a 13-month period must elapse before its entry into force with respect to the ratifying or acceding State to permit simultaneous denunciation of the 1964 Hague Convention pursuant to paragraph (3) of article [7].

Denunciation of 1964 Hague Convention, paragraphs (3) and (4)

7. Paragraph (3) provides that the denunciation of the 1964 Hague Convention is to be effective on the date this Convention enters into force with respect to that State. In the case of the first [ten] States to become parties to this Convention, such denunciation would be effective on the date the Convention comes into force. For all subsequent States, the denunciation would be effective [thirteen] months after the date of the deposit of the instrument of ratification [, acceptance, approval] or accession.

8. Should the Commission wish to allow the two Conventions to have a certain amount of concurrent operation then a provision similar to article VII, paragraph 2 of the 1958 Convention of the Recognition and Enforcement of Foreign Arbitral Awards could be used.[15]

9. Paragraph (4) of this article is a procedural measure requiring the depositary to notify the Government of the Netherlands of the entry into force of this Convention so that it is aware of the effective date of any denunciations of which it may already have been notified.

Article [8]. Denunciation

(1) A Contracting State may denounce this Convention at any time by means of a formal notification in writing addressed to the depositary.

(2) The denunciation takes effect [on receipt of the formal notification] [twelve months after the formal notification is received] by the depositary. [Where a longer period is specified in the formal notification, the denunciation takes effect upon the expiration of such longer period after the notification has reached the depositary.]

Prior conventions and draft articles

Convention on the Limitation Period, article 45.

1964 Hague Convention, article XII.

Draft Convention on the Carriage of Goods by Sea, A/CN.9/115.[16]

Commentary

1. Article [8] prescribes the manner in which this Convention may be denounced.

Mode of denunciation, paragraph (1)

2. Paragraph (1) is in substantially the same terms as paragraph 1 of article 45 of the Convention on the Limitation Period.

Time denunciation takes effect, paragraph (2)

3. The first sentence of paragraph (2) is similar to paragraph 2 of article 45 of the Convention on the Limitation Period except that the words in the first set of square brackets enable a denunciation to take effect on receipt of that denunciation by the depositary.

4. The words in the second set of square brackets provide for a 12-month period to elapse before the denunciation takes effect. This accords with paragraph 2 of article 45 of the Convention on the Limitation Period and with paragraph 2 of article XII of the 1964 Hague Convention.

5. The International Law Commission in a commentary on a draft provision which ultimately became article 56 of the Vienna Convention of the Law of Treaties[17] stated:

> "The Commission considered it essential that any implied right to denounce or withdraw from a treaty should be subject to the giving of a reasonable period of notice. A period of six months' notice is sometimes found in termination clauses, but this is usually where the treaty is of the renewable type and is open to denunciation by a notice given before or at the time of renewal. Where the treaty is to continue indefinitely subject to a right of denunciation, the period of notice is more usually 12 months, though admittedly in some cases no period of notice is required. In formulating a general rule, the Commission considered it to be desirable to lay down a longer rather than shorter period in order to give adequate protection to the interests of the other parties to the treaty. Accordingly, it preferred in paragraph 2 to specify that not less than 12 months' notice must be given of an intention to denounce or withdraw from a treaty under the present article."[18]

6. The second sentence of paragraph (2) is taken from the draft final clauses of the draft Convention on the Carriage of Goods by Sea.

Article [9]. Authentic text

Done at ....., this day of ....., in a single original, of which the Arabic, Chinese, English, French, Russian and Spanish texts are equally authentic.

Prior conventions or draft articles

Convention on the Limitation Period, article 46.

Commentary

This simplification of article 46 of the Convention on the Limitation Period is possible because:

(i) Article [1] makes the Secretary-General of the United Nations the depositary; and

(ii) Article 77 (1) (*a*) of the Vienna Convention on the Law of Treaties provides that, unless otherwise provided in the treaty or agreed by the Contracting States, the depositary shall keep custody of the original text of the treaty.

[15] This provision reads: "The Geneva Protocol on Arbitration Clauses of 1923 and the Geneva Convention on the Execution of Foreign Arbitral Awards of 1927 shall cease to have effect between Contracting States on their becoming bound and to the extent that they become bound, by this Convention."

[16] See foot-note 1 above.

[17] Article 56 deals with the denunciation of or withdrawal from a treaty containing no provision regarding termination, denunciation or withdrawal.

[18] Draft articles on the Law of Treaties with Commentaries, adopted by the International Law Commission at its eighteenth session, comment 6 to draft article 53 (*Official Records of the United Nations Conference on the Law of Treaties*, documents of the Conference, part B (United Nations publication, Sales No. 70.V.5)).

G. List of relevant documents not reproduced in the present volume

Working Group on the International Sale of Goods, eighth session

Document reference	*Title or description*
A/CN.9/WG.2/VIII/CRP.1 ..	Article 2, proposed by the Drafting Group (Brazil, Czechoslovakia, United States)
A/CN.9/WG.2/VIII/CRP.2 ..	Article 4, proposal by the United States
A/CN.9/WG.2/VIII/CRP.3 ..	Article 4, proposal by Czechoslovakia
A/CN.9/WG.2/VIII/CRP.4 ..	Article 3A, proposal by Austria, Czechoslovakia and United Kingdom
A/CN.9/WG.2/VIII/CRP.5 ..	Article 5, proposals of the Observer from the Federal Republic of Germany
A/CN.9/WG.2/VIII/CRP.6 ..	Article 4, proposal by Austria, France, the United Kingdom and the USSR
A/CN.9/WG.2/VIII/CRP.7 ..	Article 1, proposal by the Secretariat
A/CN.9/WG.2/VIII/CRP.8 ..	Proposal by Hungary
A/CN.9/WG.2/VIII/CRP.9 ..	Article 6A, proposal of the Observer from the German Democratic Republic
A/CN.9/WG.2/VIII/CRP.10 .	Proposal of the Observer from Finland
A/CN.9/WG.2/VIII/CRP.11 .	Proposal by the Secretariat
A/CN.9/WG.2/VIII/CRP.12 .	Article 6, proposal by Poland
A/CN.9/WG.2/VIII/CRP.13 and Add 1-9	Draft report of the Working Group on the International Sale of Goods on the work of its eighth session (New York, 4-14 January 1977)
A/CN.9/WG.2/VIII/CRP.14 .	Text of article 5
A/CN.9/WG.2/VIII/CRP.15 .	Article 8, proposal by Hungary, Philippines and the United States
A/CN.9/WG.2/VIII/CRP.16 .	Article 8, proposal by Czechoslovakia and the United States
A/CN.9/WG.2/VIII/CRP.17 .	Text of article 12
A/CN.9/WG.2/VIII/CRP.18 .	Text of article 11
A/CN.9/WG.2/VIII/CRP.19 .	Text of article 6
A/CN.9/WG.2/VIII/INF.1 and Corr. 1	List of participants: members of the Working Group

II. INTERNATIONAL PAYMENTS

A. Report of the Secretary-General: study on security interests (A/CN.9/131)*

1. At its third session the Commission requested the Secretary-General to make a study of the law of security interests in the principal legal systems.[1] At the request of the Secretary-General, this study was prepared by Professor Ulrich Drobnig of the Max Planck-Institut für Ausländisches und Internationales Privatrecht (Max Planck Institute for Foreign and Private International Law) of the Federal Republic of Germany. It was presented to the Commission at its eighth session.[2]

2. During the discussion of the study at it eighth session the Commission noted that it did not include references to the law of security interests in socialist countries and requested that it be completed by including such references.[3] Furthermore, it was requested that, because of its importance, the study, which had appeared in English only, be published in all the languages of the Commission.

3. In conformity with the request of the Commission, references to the law in socialist countries have been added. One other minor change has been made to indicate a recent change in the law in the United States of America in respect of security interests in railroad rolling stock.[4] Otherwise the study is reproduced in the annex hereto as it was originally prepared by Professor Drobnig.

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* 15 February 1977.

[1] Yearbook . . . , 1968-1970, part two, III, A, document A/8017, para. 145.

[2] International Payments: Study on Security Interests, ST/LEG/11.

[3] *Official Records of the General Assembly, Thirtieth Session, Supplement* No. 17 (A/10017), para. 63. (Yearbook . . . , 1975, part one, II, 1).

[4] See section 2.5.3.3 of the study.

ANNEX

Legal principles governing security interests

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1. Preface

1.1 *The assignment*

The Secretariat of the United Nations Commission on International Trade Law (UNCITRAL) has requested me to submit a study on the legal principles governing security interests in the various legal systems of the world, with special reference to those aspects which have particular relevance for international trade. I have been asked to take existing studies in this area into account and to make use of replies given by 19 Governments in response to a request for information prepared by UNCITRAL.

The conclusions of this study may serve to promote international trade law at two different levels. They may be used in the first place to suggest possible improvements in the rules of individual national systems—perhaps by the elaboration of one or more model laws. But the study may also help to consider the necessity or desirability of framing rules in this field on an international level, especially for the international movement of goods subject to security interests.

1.2 *Scope of study*

Since a study of comprehensive and all-embracing scope was neither feasible nor intended, a number of limitations have had to be made as regards the subject-matter, and the geographical scope of legal systems covered.

(*a*) As regards the subject-matter, the study deals almost exclusively with *non-possessory security interests*. This limitation is justified by the fact that under present-day conditions such a security is by far the most important, especially in international trade relations (see *infra* 2.1.1).

However, non-possessory security interests affecting ships and aircrafts have been excluded because these, to some extent, have already been unified by certain international conventions.

Also excluded from consideration are the special rules relating to instalment sales. These do not, in general, relate to transactions between merchants—or are otherwise inapplicable to mercantile transactions because of a maximum limit as to the purchase price. Moreover, they affect primarily the contract of sale rather than any security aspect that may also be involved.

Even within the remaining vast field further limitations have had to be made. Thus only those issues have been emphasized which comprise, in the view of the author, the key problems for the elaboration of improved national laws or international rules.

(*b*) Because of the limited time at my disposal it became necessary to use *legislative material* as the primary source of information regarding individual legal systems. I have attempted, where practicable, to check this material as to its practical application. Indeed, the replies given by the various Governments to the UNCITRAL questionnaire rely mainly on this source, mostly even omitting any reference to special provisions.

Existing studies on security devices proved, contrary to earlier expectations, to be of little assistance since only a very few exist and these, moreover, are of limited coverage. Inevitably therefore much more reliance has had to be placed on primary sources of legislation than had originally been envisaged.

(*c*) *Geographically*, an attempt has been made to cover all material which seemed worthy of note, wherever to be found. Special emphasis has been placed on the more important legal systems of Europe, the Americas and Australia; unfortunately material from the other continents has not proved easy of access.

2. National systems of security interests

2.1 *Introduction*

2.1.1 *Major types of security interests covered*

Despite the innumerable variations in security interests existing in the various countries of the world, a basic distinction may be discerned virtually everywhere between possessory and non-possessory security interests. These terms describe respectively whether possession of the encumbered property is or is not passed to the *creditor*.

2.1.1.1 *Possessory security interests*

The most typical possessory security interest in the *pledge*, which probably exists in all countries of the world. It is based upon an agreement between debtor and creditor. Possessory security interests may also arise by operation of law. We shall deal with statutory *liens* and statutory rights of *retention* only incidentally.

Under the traditional rules of pledge, the debtor hands over the goods to be encumbered, either to the creditor himself or to a third person who holds them for the creditor, the debtor retaining ownership in the goods. The transfer by the debtor of possession of the goods pledged is justified by two major considerations: firstly, it protects the secured creditor against unauthorized dispositions by the debtor of the goods encumbered; secondly, it protects third persons, especially other (existing or potential) creditors of the debtor, against erroneous assumptions as to the extent of property owned by the debtor and thus (indirectly) as to his ability to pay.

The practical importance of possessory security interests, especially the pledge, has, for decades, been steadily decreasing. In a purely commercial context (where both the creditor and the debtor are merchants), one will find today only a few exceptional situations in which the pledge is still being used as security. The most important of these is in sales against documents; it is also employed when valuables are used as security (see *infra* 2.2.2).

Apart from these special situations, the fundamental drawback of possessory security interests is the requirement of handing over the goods encumbered. The primary disadvantage falls upon the debtor, who is normally the owner of such goods, since these goods are often indispensable to his business, as equipment, raw materials or merchandise. If the debtor is not able to use, and/or dispose of, these objects, his ability to repay the credit granted will be seriously impaired.

But also the secured creditor will usually be unwilling or unable to receive and store the debtor's equipment, raw materials or merchandise. These practical drawbacks of the pledge have led to the development of a wide variety of non-possessory security interests.

2.1.1.2 *Non-possessory security interests*

During the last 100 years, an amazingly broad spectrum of non-possessory security interests has been developed the world over. Both the practical results that can be achieved with these devices as well as the juridical mould into which they are cast, vary not only from country to country, but often even within one and the same country.

While the more important substantive rules and their practical effects will be discussed in detail later (*infra* 2.3), the major differences in construction and the relative weight to be accorded to each will be pointed out forthwith.

2.1.2 *Differences of legal construction*

If we survey the whole range of security interests, possessory and non-possessory, from the viewpoint of their juridical construction, the great variety of very different institutions can be reduced to a very few basic models. These basic patterns in conceiving of a security interest often recur under quite varied guises. The four basic models are pledge, mortgage, ownership and privilege.

2.1.2.1 *Pledge*

The pledge as the prototype possessory security interest arising from a contract between debtor and creditor is so universal and familiar as not to require further analysis at this point (see *supra* 2.1.1.1). It is most remarkable that the central element of pledge, the handing over of possession by the debtor, has, in essence, withstood all attacks.

It may be mentioned, though, that by means of certain special devices the pledge has been adapted to a few non-possessory

situations. Austria and some South American countries (such as Brazil and Panama) allow a so-called "*symbolical handing over*". This is limited in Austria to heavy equipment and similar objects whose physical delivery would be very difficult; no comparable restriction seems to exist in the aforementioned South American countries. In some Eastern European countries the pledge may be non-possessory if specifically stated in a special statute or in the contract (USSR) or if it is in favour of a specific credit institution (Hungary). Another example is the (former) American *field-warehousing* system where the encumbered goods remain on the debtor's premises, although guarded by a detached employee of the secured creditor. A third and most common exception is the pledging of *goods represented by a document* where only the document is handed over by the debtor, while the goods themselves remain in his possession. These examples show that the pledge in certain cases no longer fits the description of a possessory security interest. In marginal situations it may serve practically as a non-possessory security interest.

2.1.2.2 *Mortgage*

The real estate mortgage, a non-possessory security interest in immovables, has served in several countries as a model for developing a non-possessory security interest in movables. Terms such as the American "chattel mortgage" or the Spanish "*hipoteca mobiliaria*" demonstrate the attractive influence exerted by the real estate mortgage. More telling than the similarity in terminology are the substantive and formal analogies derived from the real estate mortgage. The most significant is the idea that the protection of third persons requires publicity of chattel mortgages and that this should be organized along the lines of the real estate mortgage recording system.

Although a general analogy to the real estate mortgage would appear to be a particularly fruitful starting point for the development of a non-possessory security interest in movables, only a relatively small number of countries have taken this direct approach. One of these countries is the United States where the chattel mortgage was used for many years before being absorbed by the unitary "security interest" of the Uniform Commercial Code. Another such group of countries includes Spain and the Spanish speaking countries of Latin America. In these States, the "*hipoteca mobiliaria*" and the "*prenda con registro*", respectively, have been very well developed by relatively recent legislation and play dominant roles as instruments of security.

Typically, mortgages of movables serve to secure advances made by lenders of money such as banks, mainly in those countries where sellers on credit have at their disposal other special security devices, such as the reservation of title or hire-purchase. Where, on the other hand, this "division of labour" does not exist (as in France and some South American countries), the mortgage is also used to secure the seller's purchase-price for the goods sold.

The mortgage is adapted and applied to movables may be called the only "full" non-possessory security interest in movable goods. In some countries, however, two other forms of non-possessory security interest, in fact, play a much more important role than the mortgage. One of these is ownership, the other privilege.

2.1.2.3 *Ownership*

The practical importance to be attributed to ownership as a tool for developing non-possessory security interests can hardly be overestimated. The use (or abuse) of ownership as a driving force for developing modern forms of security would make fascinating reading for a student of modern legal history as well as for an astute observer of contemporary practices in the field of secured financing.

In sharp contrast to this modern practice, some legal systems and a number of writers tend to negate the functional use of ownership for security purposes on the ground that ownership is outside the traditional categories of security interests. Even a recent *comparative* study of security interests in Europe has not hesitated to exclude on this ground all proprietary devices from its purview.

Conseil de l'Europe, *Aspects internationaux de la protection juridique des droits des créanciers* (cited as "French Study"), 47.

This would seem to be an unacceptable formalism. The paramount consideration both for a comparative study and in any attempt at regulation of security interests must be the functional uses to which different legal institutions are put. The legal character of these institutions must remain irrelevant to a proper delimitation. This working hypothesis is fully borne out by the conclusion which Goode and Ziegel have reached in their conceptual analysis of hire purchase, conditional sales and mortgages.

> "It is to be hoped that the title concept which remains so firmly embedded in the laws of the Commonwealth countries, and which is largely responsible for the anomalous differences in legal effect between one security device and another although both may have been intended to achieve the same result, will in due course be abandoned in favour of the functional approach embodied in the Code" (art. 9 of the American Uniform Commercial Code). Goode and Ziegel, *Hire-Purchase and Conditional Sale*, 146.

Recourse to ownership as a means of security is had in different forms.

The most famous is the *reservation of ownership* (retention of title, conditional sale, etc.). It was first used by sellers who allowed their buyers time to pay the purchase price, securing this credit by retaining title in the goods. This reservation of ownership appears to be most natural since it is but a modification of an ordinary contract of sale under which a buyer pays upon receipt of the merchandise and the seller simultaneously transfers title to the buyer.

While originally limited to the seller financing his own sales, reservation of ownership is today extended in many countries to sales financed by third parties.

Another form of secured financing of sales utilizes ownership in the form of *hire-purchase* (*location-vente*, etc.). A seller who sells on credit leases the goods to a person who intends to purchase them. The prospective purchaser receives possession of the goods and is obliged to pay hire charges (in practice a sum constituting the instalments of the purchase-price) to the seller/lessor. Upon completion of these payments, the hirer either receives, or has an option to call for, title to the goods.

This method is also easily adaptable to secured financing of sales by third parties.

Under certain circumstances, financed *leasing* may be viewed as a modern variation of hire-purchase.

A third major form of security through ownership is represented by the "*security transfer of ownership*" which has been developed in a few countries after the German "*Sicherungsübereignung*" model. The English bill of sale, the Mexican use of the "*fideo comiso*" and perhaps also the Anglo-American trust receipt are equivalent devices, as was the American chattel mortgage before it came to be regarded as a mortgage proper. The security transfer of ownership is typically used to secure loans. The debtor transfers to the creditor title, but not possession, of the goods to be encumbered. The creditor retains title until the secured credit is repaid, and then retransfers it to the debtor.

Two features are characteristic of all three major forms of ownership-security. First, the creditor as owner holds more rights than he requires for security purposes. This surplus of rights is a major source of conflict with the debtor as well as with third parties. Second and paradoxically, many countries are less suspicious of the more or less open recourse to ownership as security than they are of other forms of non-possessory security. While the latter are usually regulated rather strictly, ownership is often accepted as ownership pure and simple, irrespective of the concrete function it may be serving. The enormous attraction inherent in ownership-security in certain

countries springs from this liberality in disregarding the very different functions for which ownership is used.

2.1.2.4 *Privilege*

While ownership-security endows the secured creditor with a surplus of rights, privileges, a minor form of non-possessory security interest, grant less security to the creditor than the ordinary device of mortgage.

Two kinds of privileges should be distinguished both of which are relevant for security interests, namely general and special privileges.

A general privilege gives a preferred rank to certain classes of claims, which can be satisfied from the whole property of the debtor. Fiscal claims enjoy such a preference in very many countries. Since the applicable law determines the precise rank of such a general privilege, it may or may not take priority over a claim secured by a security interest. If it does take priority, the value of the security is of course diminished. We will deal with this problem in discussing the protection of a security interest as against third parties.

A special privilege gives a preferred rank to certain classes of claims which may be satisfied—in contrast to a general privilege—from only certain specific goods of the debtor. It thus resembles a conventional security interest.

This study will consider only the most important privilege, that acquired by the unpaid seller of movable goods, which is recognized in many, but by no means in all, countries. However greatly the conditions and especially the effects of the seller's privilege may vary from country to country, it has at least two features in common in all jurisdictions where it is recognized: it comes into existence by operation of law if a seller is not paid for the goods sold; and its effects are generally limited to the time during which the goods sold remain in the hands of the buyer. However, even during this period the privilege is generally not effective in the buyer's bankruptcy.

It is this lack of effectiveness vis-à-vis all third persons which diminishes the practical value of the seller's privilege, making it merely a second-rate security device. On the other hand, the fact that it comes into existence by operation of law makes it applicable to all sales contracts, irrespective of the agreement of the parties. This feature facilitates its treatment within general legal principles since it eliminates the need to take into account the multifarious deviations of individual contract terms.

It should be pointed out, though, that in a few instances, sometimes with the help of registration, privileges have achieved the status of a full security interest. The most notable example is the statutory privilege of automobile sellers in Italy, which is subject to registration and is effective against third persons. It co-exists with a contractual privilege that may be granted by an owner to any other creditor, under the same conditions and with the same effects. Fifteen years after its birth, this combined statutory and contractual privilege was reclassified by the Italian legislature as a mortgage.

Italy: See Decreto-legge 15 March 1927 art. 2 and Codice civile of 1942 art. 2810 para. 3.

The curious ambivalence of this particular security interest, both in substance and in classification, proves that the gap between mortgage and privilege is not unbridgeable.

This leads us to a consideration of the real value of the various types of security interests and of the general legal construction underlying their differentiation.

2.1.2.5 *Actual and artificial distinctions*

In evaluating the four basic types of security interests presented here in general terms (pledge and mortgage, ownership and privilege), we must begin by inquiring into the extent to which the distinctions and delimitations between the four types correspond to modern commercial realities. Only those differentiations which comply with this criterion can be accepted as inherently sound. All others, for whatever constructive reason or historical accident imposed, must be deemed spurious and therefore unhelpful.

The basic cleavage underlying the pledge-mortgage dichotomy proceeds from whether or not the secured creditor has possession of the encumbered goods. It stands to reason that the locus of possession is a highly relevant factual circumstance from which important legal consequences may ensue. On the other hand, we have seen that the pledge cannot always be identified as a possessory security interest since the term covers certain instances of a non-possessory nature (*supra* 2.1.2.1). Therefore, we shall substitute in our study for the term "pledge" the more fact-orientated term "possessory security interest".

The range of non-possessory security interests may thus be seen to include all the four basic devices, with the pledge occupying a marginal position. We shall expect a qualitative distinction between the full security devices on the one hand and the lesser device, the privilege, on the other. However, even here we have to be guided not by the name of a concrete institution, but by its real effects.

There remains the question as to the validity of the distinction between the (exceptional) non-possessory pledge, the mortgage and ownership-security. Historically and functionally speaking, it is obvious that all three devices serve but one purpose, namely to give real security to a creditor who is not in possession of the encumbered goods. Although their identity of purpose does not imply that the effects of all three constructions are identical, a broad comparison of non-possessory security interests would be impossible if the functional identity of purpose were not placed above the more or less accidental legal constructions. We will therefore gather all devices, creating a full non-possessory security, whatever their designation, under this functional name. It is necessary to emphasize that all "proprietary" devices based upon the utilization of ownership for purposes of security will also be covered under this head. Only those institutions which do not achieve the full status of a security interest will be called by their traditional name, i.e. privilege.

2.1.3 *Outline and approach*

The three classes of security interests which result from the functional approach to the subject-matter (see *supra* 2.1.2.5) determine the basic scheme of the following analysis. Our discussion of the infinite variety of national security interests will thus be conducted in three major parts:

(1) possessory security interest (*infra* 2.2);

(2) non-possessory security interests on a contractual basis (*infra* 2.3);

(3) statutory non-possessory security interests in favour of the seller (*infra* 2.4).

This scheme gives rise to two other issues of methodology.

In the first place, we shall have to disregard the concrete economic situations in which security is demanded and granted. Certainly one would expect differences to exist between security granted by a consumer and that by a trader, or between security offered by an industrial enterprise and one by a farmer, etc. Even the security offered by the same person, like an importer may vary at different stages of an import transaction, e.g. during shipment, subsequent to arrival, etc. Our disregard of these innumerable, varied economic situations is based on two grounds. For one, most of the national rules do not differentiate along such lines. But even where they do, recent codifications tend to establish a uniform régime, the most notable example being the *United States'* Uniform Commercial Code art. 9 which has created a uniform security interest.

Our discussion will, in general, also remain detached from the nature of the encumbered goods. Thus we will not differentiate as to whether the encumbered goods are staple goods, like grain or oil, or manufactured or semi-manufactured goods, or whether the latter serve industrial, trade or household purposes. This detachment from the nature of the charged items is again justified by the observation that on the whole neither do the national legal rules differentiate in this respect. One exception, however, has been made in deference to national experiences: the means of transport dealt with here, namely

automobiles and railway rolling stock, will be treated separately (see *infra* 2.5).

2.2 *Possessory security interests*

We have already pointed out the major drawbacks of the pledge, the lien and the right of retention, the most typical possessory security interests (*supra* 2.1.1.1).

2.2.1 *Reasons for decline*

The above-noted practical disadvantages of possessory devices, both for the debtor and the secured creditor, are primarily responsible for the decline of possessory security interests in contemporary commercial practice. The decline in significance of the pledge has been balanced by the tremendous increase in the practical role of non-possessory security interests.

2.2.2 *Residual applications*

Despite the general decline of possessory devices, however, they continue to play an important role in a few special areas. By far the most significant of these is the giving of secured credit in connexion with *sales against documents*. Typically this situation arises in connexion with a letter of credit. A bank which has issued a letter of credit on the account of an importer (or a domestic buyer) will often be willing to extend credit to him until such time as he will be able to reimburse the bank from the resale proceeds of the acquired goods (self-liquidating credit). The documents of title representing these goods (such as bills of lading or warehouse receipts) are usually endorsed and handed to the bank. The latter than delivers the documents under precautions to the buyer to enable him to receive the goods from the ship, submit them to customs inspection and sell them. The security interest under which the bank holds the documents (and the goods represented by them) is a pledge. This classification may not be so obvious since the bank's possession of the goods is only indirect. The goods are "represented" by documents of title, i.e., special documents which by virtue of commercial usage or express legislation are the exclusive embodiment of the goods for which they have been issued. This exclusive character is guaranteed by the obligation of the issuer to deliver the represented goods only to the holder of the document and upon its presentation.

Another instance in which possessory security is utilized, although of comparatively modest importance, is the pledging of *valuables and investment securities*. Gold and jewels as well as bonds and share certificates are the items most frequently pledged in a commercial context. They are also used in the lending practices of international banks.

See Delaume, *Legal Aspects of International Lending and Economic Development Financing (Dobbs Ferry, 1967) 234-236.*

The advantages of such collateral are threefold: they are not usually necessary to the debtor's economic existence; the creditor can easily store and thus secure them against disloyal dispositions by the debtor; and they are easily marketable.

Only the happy coincidence of these elements, especially the first two, makes the pledging of these objects economically practicable. But these items' special characteristics also demonstrate a negative point. Possessory security covering other items is generally impracticable if and in so far as the debtor cannot dispense with possession, and the creditor cannot accept it.

This analysis of the two commercially useful applications of the possessory security device thus explains at the same time why possessory devices in general do not meet modern business requirements. Our attention will therefore centre upon the non-possessory security interests.

2.2.3 *Legal régime*

In addition to the very limited commercial utility of possessory security interests, another factor also militates against the discussion of these devices. A very rough survey indicates that the conditions for the creation of possessory security interests are very similar everywhere. The same is true of the effects that attach to these devices. Some divergencies arise only when it comes to their enforcement. Thus the relevance and utility of a comparative analysis of possessory security devices would be very limited.

2.3 *Contractual non-possessory security interests*

The interests in this category may be broadly divided into security interests created by agreement between a creditor and a debtor (contractual interests) and other security interests or privileges arising by operation of law (statutory interests). The presence or absence of an agreement in this respect gives rise to so many different legal consequences that it is best to discuss the two classes separately.

It is not always easy to say when a security interest is contractual or statutory. Sometimes an interest is regarded as statutory for one class of creditors, but as contractual for all other creditors; interests of this dual nature are discussed twice, in the appropriate category of creditors. Some ambiguity is also created by statutory interests, the effects of which vary according to whether or not the secured creditor provides for registration of the interest. Although this *onus* to register is akin to a feature of contractual security interests, the essential element of a contractual interest, viz. the agreement between the creditor and the debtor, is lacking. These interests will therefore be classified as statutory.

The discussion which follows will deal only with what one may call "full security interests", i.e., security interests having legal consequences which affect third persons as well as the immediate parties. Such an enlarged effect is particularly relevant in cases of conflict with the other creditors of a debtor. It is generally accepted that it is this capacity of a security interest to affect the position of persons other than the contracting parties which distinguishes a proprietary interest from a purely contractual arrangement affecting only the immediate parties thereto.

2.3.1 *Typical purposes*

Underlying the various objects of individual security agreements are a few general aims which are typical for certain recurring situations.

Generally it may be said that all non-possessory security interests permit the debtor to retain possession of the encumbered goods with freedom to utilize or dispose of the same.

In many situations the parties, or at least the creditor, envisage that the debtor will retain the encumbered goods because he has acquired them for his own needs. These may be of a private or of a business character. Durable household goods such as refrigerators or television sets would fall into the private category. Utilization for business purposes may relate to fixed and mobile equipment such as cars, cranes and machines of various kinds. In all these cases the creditor will usually oblige the debtor not to dispose of the encumbered goods. Should the debtor, by abusing his right of possession of the encumbered goods, dispose of the latter, he would break his contractual obligations and may even incur penal sanctions.

The situation is quite different if both parties envisage that the debtor shall have the right to dispose of the encumbered goods. This happens when a trader encumbers his stock of merchandise or an importer charges acquired goods as security, either during transit or after arrival. The declared intention of the debtor to sell these goods at some time or other introduces an important new element.

The debtor's right to utilize or dispose of the encumbered items is primarily of economic significance. Many legal rules which take a very broad view of the subject disregard this distinction. There are, however, other legal systems, especially those which impose limitations upon security devices, which invest this factual distinction with important legal consequences (see *infra* 2.3.2.3.2 sub (b)).

2.3.2 *Restrictions on security interests*

The various restrictions on non-possessory security provide a clear illustration of the widespread distrust with which these arrangements are viewed in many countries. A possible reason

for this may be the desire to protect unsecured creditors and other third persons whose chances of obtaining satisfaction from the debtor may become jeopardized as a result of the preferential treatment of secured creditors (see *infra* 2.3.2.5). Such restrictions may affect either the parties involved, the secured claims, or the encumbered goods. Since these restrictions are sometimes quite extensive, and may thus present a serious obstacle to international trade, the three types of restrictions deserve careful attention.

2.3.2.1 *Restrictions as to parties*

The restrictions as to parties may apply to creditors or debtors.

(*a*) Most frequent are rules which limit the category of *secured creditors*. Thus *Argentina* restricts the category of the possible creditors of a *"prenda con registro"* to the state or its autonomous subdivisions, banks, co-operatives, agricultural and industrial companies, merchants listed in the commercial register, and registered money-lenders. International financing institutions of which Argentina is a member and foreign exporters were added to this list by an amendment of 1963.

Argentina: Ley no. 12, 962 on prenda con registro of 1947, as amended in 1963, art. 5. Similarly *Venezuela*: Ley de hipotecas mobiliaria of 1973, art. 19.

In certain other countries the permissible creditors form a much smaller group and the security interest concerned is at the same time more specialized (see on this more particularly *infra* 2.3.2.2.). Thus *Belgium, Egypt* and *Luxembourg* only allow banks approved by the Government to become creditors of mortgages on business enterprises (*fonds de commerce*),

Belgium: Loi of 25 Oct. 1919, as amended, art. 7; *Egypt*: Loi no. 11 of 29 Feb. 1940, art. 10; *Luxembourg*: Arrêté 27 May 1937, art. 12.

while *France* imposes no personal limitation on this kind of security interest. Some countries, such as *Federal Republic of Germany, Japan, Switzerland, Turkey* and *Uruguay*, restrict the category of creditors qualified to accept certain agricultural security interests,

Federal Republic of Germany: Law on credits for agricultural leases of 1951, 1; *Japan*: Farming Movables Credit Law of 29 March 1933, art. 3; *Swiss* Civil Code art. 885 para. 2; *Turkish* Civil Code arts. 868-869; *Uruguay*: Ley No. 5.649 of 21 March 1918 sobre prenda rural, art. 4,

with the obvious purpose of protecting farmers as debtors against unscrupulous money-lenders.

In some Eastern European countries only certain banks or other organizations can take a security interest.

German Democratic Republic: Civil Code of 1975, para. 448; *Hungary*: Civil Code of 1959, para. 262; *Poland*: Civil Code of 1946, art. 308.

A few other countries restrict the category of permissible creditors even further by authorizing one specific bank to accept certain security interests, thus impliedly barring all other creditors. Examples of such a limitation are furnished by *Egypt, Greece, Norway* and *Venezuela*, and relate to an agricultural bank.

Egypt: Loi no. 28/1940, on certain derogations from the rules of the Civil Code on pledges of 25 May 1940, art. 1 para. 2; *Greece*: Legislation on the Development Bank; *Norway*: Law of 5 Feb. 1965 on the State Agricultural Bank, § 16 no. 1 para. 2; *Venezuela*: Ley del Banco agrícola y pecuario of 29 May 1946, arts. 51 *et seq.*

It is possible and even probable that there are many other instances of "privileges" of this kind which are difficult to trace since they may be hidden away in specialized statutes.

(*b*) Express restrictions as to *debtors* are rare. Many restrictions of this kind are implied in the limitations on goods suitable as security (*infra* 2.3.2.3.2). We shall therefore mention only those subjective restrictions which apply irrespective of the nature of the thing encumbered.

Most noteworthy because of its widespread use is the restriction on the *English* (fixed or floating) charge. This may only be created by an incorporated company, not by an individual debtor. There does not seem to be any rational explanation for this discrimination against natural persons (to whom only the ill-reputed bill of sale is available as a security device for loans).

Paraguay furnishes another example. A chattel mortgage (*prenda con registro*) may only be created by industrial entrepreneurs, artisans, farmers and cattleraisers as well as legal entities created by these persons; by private persons only if the goods encumbered are automobiles or machines in general.

Paraguay: Decreto-Ley no. 896 on prenda con registro of 1943, art. 4.

In *Czechoslovakia* the provisions on security interests in the International Trade Code of 1963 apply only to entities which engage in international trade transactions.

2.3.2.2 *Restrictions as to secured claims*

Of fundamental importance to the economic function of non-possessory security interests are the limitations as to the types of claims these interests may secure. The limitations imposed vary considerably among the various legal systems.

The world may be divided under this topic into three groups: countries which allow security interests only for purchase money claims; countries which allow security interests for purchase money claims and some other claims; and finally countries which do not restrict the nature of the claim to be secured.

A claim for purchase money, as used here, connotes primarily the seller's claim to the purchase-price of the goods, but may also consist of a loan granted to the buyer with which the latter may pay the purchase-price of some item.

The term and its definition are derived from *United States* law, see Uniform Commercial Code s. 9-107.

For the purposes of the following survey the specific legal form in which a non-possessory security interest may appear has been disregarded. On the other hand, only those security interests which are full security interests having effect in the buyer's bankruptcy, are taken into account.

(1) The first group comprises those countries which in effect admit only security interests for purchase money claims without imposing restrictions on the thing sold:

Austria, Egypt, Ethiopia, Italy, Lebanon, Switzerland, Syria and Turkey.

(2) The second group encompasses countries which, like the first, admit security interests for purchase money claims, irrespective of the item sold. In addition, however, they also permit security for a limited number of other claims. The limitations may be imposed upon the parties to the transaction (see *supra* 2.3.2.1) or upon the things encumbered (see *infra* 2.3.2.3):

Argentina, Finland, Greece, Japan, Norway, Sweden, Thailand and Uruguay.

(3) Into the third and largest group fall most of the other countries. In general they do not draw distinctions based on the type of the secured claim (although they may impose other restrictions, see *supra* 2.3.2.1 and *infra* 2.3.2.3.2).

2.3.2.3 *Permitted subject-matter of security*

The possible subject-matter of a *possessory* security interest is usually not limited. However, in some Socialist countries, such as the *USSR*, items that are exempt from being taken in execution may not be the subject-matter of any kind of security interest. These include mainly fixed assets and equipment belonging to State organizations, co-operatives, trade unions and other public organizations. In addition, a relatively large number of countries restrict the availability of non-possessory security by limiting the category of the items that may be encumbered.

Two problems require separate discussion: first, the technical question of the form in which these limitations are presented; second, the substantive question as to the physical items which

are either specifically included in enumerative catalogues or excluded from general clauses of admission.

2.3.2.3.1 *Typical general approaches*

At the technical level three approaches to such limitation may be distinguished: a *numerus clausus* of admissible items, the general admission of all items, and a mixed approach.

(*a*) *Numerus clausus.* The more tenaciously the security law of a country clings to possessory security, the more vigorously it will resist non-possessory security and limit the latter as strictly as possible to selected items. Countries which restrict non-possessory security interests in this way allow their creation only if, and in so far as, a statutory rule admits specific items as suitable objects of security. Some countries go so far as to establish a special statutory régime for each permitted category. A typical example of this extremely reserved approach to non-possessory security is found in *France* where one finds no fewer than nine special statutes, enacted at different dates, for varying reasons, and with differing contents for more or less narrowly defined categories.

France: Law of 17 March 1909 on the pledging of a business enterprise; Law of 8 Aug. 1913 on the hotel warrant; Law of 21 April 1932 on the petrol warrant; Law of 28 Sept. 1935 on the agricultural warrant; Décret of 24 June 1939 on the war material warrant; Law of 22 Feb. 1944 on the industrial warrant; Law of 18 Jan. 1951 on the pledging of machinery and professional equipment; Décret of 30 Sept. 1953 on credit sales of motor vehicles; Code of cinema industry of 27 Jan. 1956, arts. 31 s.

Similar collections of diverse special statutes of restricted application—although with a more modest catalogue of items covered—can be found in the neighbouring countries of *Belgium* and *Luxembourg*, as well as in some Near-Eastern countries influenced by France, such as *Lebanon*.

A higher degree of technical perfection has been achieved in numerous *South American* countries. While these countries also enumerate the permitted items of security, all such items are governed by one (or two) unified set(s) of rules, sometimes with slight variations for particular items.

As to the types of items covered, see the list offered *infra* 2.3.2.3.2.

(*b*) *The general admission of all objects* is the solution at the other extreme. This approach is followed notably in the Anglo-American legal systems, especially in the *United Kingdom* and the former and present members of the *British Commonwealth* inspired by England and in the *United States of America*, but also in *Argentina, Costa Rica, Mexico, Panama* and the *Philippines*. It is also utilized in essence in a few Central European countries, such as *Denmark, Federal Republic of Germany, Liechtenstein* and the *Netherlands*. *Colombia* admits a security interest for purchase money (see *supra* 2.3.2.2) without restriction, but limits security for other loans to those items connected with an economic activity.

Colombia: Commercial Code of 1971, art. 1207 para. 1. A similar general formula, supplementing a catalogue of specific items, is employed in *Chile*: Law No. 5687 on the contract of "prenda industrial" of 17 Sept. 1935, art. 24 in fine; *Guatemala*: Civil Code of 1963, art. 904 para. 2.

Sometimes one may find that in these legal systems a few specified items are excluded as possible objects of security.

(*c*) *A mixed system* combining general admission and *numerus clausus* has been adopted in many other States. In these countries two types of security interest exist side by side: one type places no limitation upon the permitted items, save perhaps an occasional exclusion, viz. the reservation of ownership for the purpose of securing the seller's purchase-price; the second is applicable only to selected items of property, viz. a chattel mortgage for the purpose of securing a loan creditor. This intermediate position has been adopted on a large scale, attaching great weight even to the chattel mortgage, in such countries as *Brazil, Egypt, Finland, Greece, Japan, Peru, Portugal, Spain, Sweden* and *Venezuela* (first group). In other countries, the scales are clearly tipped in favour of reservation of title, the chattel mortgage being allowed only for very few, selected items. The latter situation prevails in *Austria, Italy, Norway, Switzerland* and *Turkey* (second group).

The preceding trichotomy indicates three (or more accurately four) general approaches to non-possessory security by the various countries of the world. If we arrange these four types on a scale according to their permissiveness of non-possessory security, the following picture emerges:

Least permissive is the French system of the *numerus clausus* with a special régime for each kind of item. More permissive are the mixed systems, admitting the reservation of ownership for all items, but restricting more or less severely the goods that may be subject to a chattel mortgage. Most liberal is the system generally admitting all goods for purposes of security.

It does not appear, as one might have supposed, that a country's position on this scale is determined by its degree of economic development, since countries with quite different levels are to be found in almost every group. A better explanation is probably offered by the dates of national legislation. It appears that in general a country's security rules tend to be more liberal, the more recent its legislation in this area has been enacted, and vice-versa. This observation would indicate that the admission of a large number of, or potentially all items as suitable objects of security is to a considerable degree a matter of technical modernization of this branch of the law.

2.3.2.3.2 *Permitted and excluded items*

The category of permissible items of security in those legal systems which employ a *numerus clausus* (either exclusively or side by side with a general clause, see *supra* 2.3.2.3.1) are not selected entirely by accident, but converge to a large degree. A demonstration of this phenomenon may help to reveal possible directions of reform to countries with very restrictive régimes. This applies equally to those systems which, whilst generally admitting all items as objects of security, have attempted to exclude specific items.

(*a*) *Enumerations of permissible items of security*. The folfowing catalogue is offered because it is highly indicative of the economic relevance of non-possessory security interests in the *numerus-clausus* countries. The enumeration does not purport to be exhaustive, either as to the category of permitted items or as to countries. But it may well qualify to illustrate the trend of all *numerus clausus* legislation. Finally it should be emphasized that the precise legal form of the security interest (whether it be a reservation of title, a chattel mortgage or any other contractual interest) is entirely irrelevant in this context.

It seems convenient to divide all the items into six major groups, each with certain subgroups.

(1) *Agricultural items*:

(*a*) Comprehensive objects clause, comprising in particular crops, produce, timber, livestock and agricultural machines:

Brazil, Canada (Quebec), Chile, Cuba, Ecuador, Egypt, El Salvador, Finland, Greece, Guatemala, Honduras, Luxembourg, Mexico, Nicaragua, Norway, Paraguay, Peru, Portugal, Spain, Turkey, Uruguay, Venezuela.

(*b*) Farm inventory only: Belgium, France, Japan.

(*c*) Fishing equipment: Japan, Norway.

(*d*) Livestock: Austria, Switzerland, Turkey.

(*e*) Grain: Norway.

(*f*) Tobacco: Greece, Turkey.

(2) *Raw materials*:

(*a*) In general: Chile, El Salvador, Finland, Guatemala, Nicaragua, Norway, Peru, Portugal, Sweden, Uruguay, Venezuela.

A geographical peculiarity is to be noted in El Salvador: only raw materials for use in national industries are covered (see *infra* (*b*)).

(*b*) Coal: Belgium.

(*c*) Petrol stock: France.

(*d*) Salt: Brazil.

(3) *Industrial equipment:*

(*a*) In general: Brazil, Canada (Québec), Chile, Cuba, Ecuador, El Salvador, Finland, France, Greece, Guatemala, Honduras, Korea (South), Lebanon, Nicaragua, Norway, Paraguay, Peru, Portugal, Spain, Sweden, Thailand, Uruguay, Venezuela.

(*b*) Construction machinery: Japan.

(*c*) Vehicles: Chile, Panama, Spain, Venezuela; see also automobiles, *infra* (*e*).

(*d*) Salt production equipment: Brazil.

(*e*) As to automobiles, see *infra* 2.5.1, and as to railway rolling stock, see *infra* 2.5.2.

(4) *Industrial products:*

(*a*) In general: Chile, Ecuador, El Salvador, Finland, Guatemala, Nicaragua, Norway, Portugal, Uruguay, Venezuela.

A geographical peculiarity is to be noted in Costa Rica, El Salvador, and Uruguay: these countries cover only industrial products of national origin (see *infra* (*b*)).

(*b*) Films: Egypt, France, Greece.

(5) *Funds:*

(*a*) Business enterprises (*fonds de commerce*): Belgium, Egypt, France, Lebanon, Luxembourg, Spain, Tunisia, Venezuela.

(*b*) Hotel inventory: France, Portugal.

(*c*) Collections of art and historical works: Spain, Venezuela.

(6) *Incorporeal property:*

(*a*) Industrial property and copyright: Spain, Sweden, Uruguay, Venezuela.

(*b*) Investment securities: Chile.

This catalogue is instructive in two respects. It illustrates, in its smaller subgroups, the economic specialities of individual countries. Even more significant—because they indicate general trends of economic development—are the major subgroups, especially (1) (*a*) and (3) (*a*). These two subgroups demonstrate clearly two main areas in which the demand for non-possessory security interests has been particularly strong. These are, first, agriculture in general, notably agricultural crops, produce, timber, livestock and agricultural machines; and secondly, industrial equipment.

(*b*) *Exclusion of objects of security.* The preceding enumeration of items suitable as security impliedly excludes for the respective countries all other items as unfit for this purpose.

More interesting for present purposes, however, are the express exclusions. The list is much shorter and probably less complete since it is based on express statutory clauses and does not take into account unwritten general principles that may lead to an identical result.

This observation applies especially to the exclusion of certain goods because of their *economic function*. Thus, goods for resale are expressly excluded in *Colombia* and *Venezuela*.

Colombia: Commercial Code 1971, art. 954;

Venezuela: Decreto No. 491, on sales under reservation of ownership of 1958, art. 2.

The need for precise identification is in many countries the reason for excluding fungible goods or other goods that are not identifiable as individual items.

Chile: Law No. 4702, on instalment sale of movables of 1929, art. 1 para. 1; *Colombia*: Commercial Code of 1971, art. 951 para. 1, 953 para. 2; *El Salvador*: Commercial Code of 1970, art. 1039; *Panama*: Civil Code art. 1567 No. 3 (chattel mortgage); Decreto-Ley No. 2, on chattel mortgages of 1955, art. 12 para. 4 (sale under reservation of ownership); *Peru*: Ley No. 6565, on instalment sale of 1929, art. 1; *Venezuela*: Decreto No. 491, on sales under reservation of ownership of 1958, art. 4.

Similarly, goods to be subjected to a manufacturing process or other transformations and which are not identifiable, are sometimes excluded.

Venezuela: Decreto No. 491, art. 2.

These three related exclusions are obviously motivated by both technical and economical considerations. The legal reason for adopting the exclusionary rule is the desire to avoid the difficulties which are bound to arise if a security interest upon goods undergoing resale, manufacture or transformation is recognized. A more flexible approach, which has been adopted by many countries, would be to allow the creation in such cases of a security interest, but to terminate it upon resale, manufacture or transformation. The economic effect of the strict rule is to ban security interests in most of the commercial transactions and to limit them to consumer transactions.

A few Latin American countries have a *geographical limitation* restricting the items suitable as security to raw materials acquired for use in national industries or to industrial products of national origin.

El Salvador: Commercial Code 1970, art. 1144 No. I, or to industrial products of national origin;

Uruguay: Ley 8.292 of 24 Sept. 1928 on *prenda industrial*, art. 2 No. 5.

2.3.2.4 *Conclusions*

The analysis of the various restrictions imposed on the parties to, the claims secured by, and the subject-matter of, non-possessory security interests suggests a number of conclusions. Since the various restrictions in part overlap and their imposition can probably be explained by one or two all-pervading motives, they may all be analysed together.

(a) *Motives.* The contrast to the possessory security interest where no comparable restrictions are apparent, makes it quite clear that the distrust of non-possessory security interests is the decisive reason for the existence of the various restrictions. This is confirmed by the geographical limitations placed on the subject-matter of security by a few Latin American countries (*supra* 2.3.2.3.2 sub (*b*)). Obviously these countries regard the admission of items as suitable objects of security as a privilege which should be restricted to goods of national origin or destination. Apart from these "nationalistic" restrictions, what are the reasons which render non-possessory security interests suspect? Perhaps one can identify two main sources. One is the novelty of the phenomenon and a consequent lack of legal expertise in handling it. This, of course, is only a provisional stage of development which today has passed in general, but the traces of which are still lingering on.

Another possible source of the dissatisfaction are apparently, at least in certain countries, economic and legal reasons, especially the desire to protect unsecured creditors against the preferential treatment of secured creditors. However, whether this problem is optimally solved by the outright exclusion of persons, claims or things, appears to be doubtful.

(b) *Discussion and suggestions.* The preceding exposition of three different motives for the restrictions imposed upon non-possessory security interests suggests certain ideas and recommendations.

(1) *Geographical limitations* restricting the items suitable as security to goods of national origin or destination are certainly an obstacle to the promotion of international commerce and ought to be removed.

(2) Restrictions as to persons, claims or things which stem from the *initial distrust* of the novel phenomenon of non-possessory security are outdated by now. Our present knowledge, especially the comparison with, and evaluation of, practical experience gained in many countries, enables legislation to be drafted which can satisfactorily solve all substantive and technical problems posed by non-possessory security interests. For these reasons all restrictions which are merely traditional and therefore outdated should be lifted.

(3) A more difficult problem is posed by the restrictions based on *protective considerations*. The latter, of course, are still valid today. It is merely doubtful whether the outright exclusion of persons, claims or things is the most appropriate means of achieving the desired end. The exclusion of certain categories of non-possessory security does not solve the problem directly and is therefore, as most indirect answers, not liable to be fully adequate. Firstly, an artificial distinction is introduced which may not correspond to economic necessities. Secondly, it seems difficult to justify the privileged position of those categories of non-possessory security that are admitted as against those that are excluded. Thirdly and conversely, unsecured creditors subordinated to admitted non-possessory security interests are at a disadvantage as against those who compete *pari passu* with creditors who, for one reason or other, have been excluded by law from obtaining non-possessory security.

For these reasons it seems to be more appropriate if the protection of unsecured creditors be achieved by a more direct route and not by the inadequate means of general exclusions from non-possessory security.

2.3.3 *Creation of security interest*

The first step for the creation of a contractual security interest is obviously the conclusion of an agreement between debtor and creditor providing for the creation of a security interest by the debtor. This agreement will then serve, in different ways, as the basis for creating the security interest itself. We need not deal here with all the various requirements for the conclusion of a valid agreement since this is a matter of general contract law. Nor shall we discuss the interesting question in which way in general, on the basis of a valid agreement, the security interest itself is brought into existence.

Rather we shall concentrate on one particular problem of great practical importance, i.e. *formalities*, both as required for the underlying contract and for the creation of the security interest itself. National legal systems are amazingly varied in this respect. In a few countries no particular formalities have been prescribed. In others only one step, namely the drawing up of a formal contract, is necessary. In many, if not most countries, two steps are required, before full effect can be given to a security interest: in addition to the drawing up of a proper document, its registration or registration of the security interest is necessary. In some cases, registration only is required, without a formal document. Finally, in a small number of instances an additional third step may be prescribed, such as physical marking of the encumbered items.

We shall see moreover that most of these four variations are themselves quite complex since some of them cover a wide variety of different requirements and effects.

2.3.3.1 *Absence of formalities*

Fewer than a dozen countries, most of them situated in central and northern Europe, dispense altogether for all or at least for certain kinds of security interests with formalities.

The most radical in this respect are *Germany* and the *Netherlands* which admit security interests both for purchase money (see *supra* 2.3.2.2) and for non-purchase money, without any formal requirements. It is to be noted, however, that the new draft Dutch Civil Code envisages a system of registration.

Netherlands: Government draft of book 3 of the new Civil Code (Zitting 1970-1971 no. 3770 no. 8), art. 3.1.2.1 ff. and 3.4.2.2 para. 3.

In the next class are those countries which, in general, have a security interest only for purchase money, but allow this without formality. *Austria* appears to be the only representative of this group.

The largest category comprises those countries which, like the first group, admit security interests both for purchase money and for non-purchase money, but dispense with formalities only in the case of purchase money security interest. Into this group fall the four Scandinavian countries (*Denmark, Norway, Sweden and Finland*) as well as *England* (and the *Commonwealth* countries in general), *Greece, Japan and South Africa.*

It should be mentioned, however, that in almost all cases of some commercial importance the parties do in fact draw up a written contract in order to avoid doubts and uncertainties as to their mutual rights and obligations.

2.3.3.2 *Formal contract*

In discussing the requirements of a formal contract it is useful in the first place to distinguish between rules requiring the writing as the only formality and other rules requiring a second formal step, especially registration.

(a) *Formal contract as the only formality*. Only very few countries are satisfied with a formal contract as the exclusive requirement either for all security interests or for one of several types.

Iran represents the former approach. It provides for a notarial instrument to be drawn up in order to constitute a non-possessory "pledge".

Iran: *Devel*, Iran p. 3.

In *Czechoslovakia and Hungary*, a contract embodying a reservation of ownership need only be in writing.

Czechoslovakia: International Trade Code of 1963 s. 324 para. 1;

Hungary: Civil Code of 1959, para. 370.

In *Egypt, Italy, Poland and Spain*, security interests for purchase money are effective as against third persons only if the contract creating the security interest is dated in such a way that it may be said to have a "certain date".

Egypt: see Civil Code art. 395; *Italy*: Codice civile art. 1524 para. 1; *Poland*: Civil Code art. 590 para. 1; *Spain*: see Civil Code art. 1227.

This technical requirement is designed to prevent frauds which could be committed against (other) creditors of the debtor by antedating the seller's security interest. According to three of the legal systems mentioned, the certainty of the date may be fixed by registration of the document, by certification by a public official, by the death of the signatory or by other events establishing with certainty the date of the instrument.

Egypt: Civil Code art. 395 para. 1; *Italy*: Codice civile art. 2704 para. 1; *Spain*: Civil Code art. 1227.

It should be pointed out that in Italy the effects as against third persons of a security interest for purchase money in machines exceeding certain sums can be increased by registration and other forms of publication (see *infra* 2.3.3.3 and 2.3.3.4).

The situation in *Venezuela* is for reservations of ownership very similar to that in the aforementioned group of countries. A security interest for purchase money must be created by a public document or in a private document with certain date. But the certainty of the date can only be achieved by the deposit of a signed copy of the contract with a notary or a judge at the seller's domicile.

Venezuela: Decreto no. 491 on sales under reservation of ownership of 1958, art. 5 lett. b).—*Quaere*, how the certainty of a private contract can be achieved where the seller resides outside Venezuela?

In addition, *Venezuela* also provides that the contract must contain certain basic details; these are the parties' names, description and location of the encumbered goods, purchase price and terms as to payment.

Venezuela: Art. 5 lett. a).

The *USSR* also requires the written contract between the parties to include similar information in respect of the parties and the goods which are the subject of the agreement.

USSR: Civil Code of the RSFSR of 1964, s. 195.

Perhaps *Chile* can also be mentioned here. The contract for a *prenda industrial* becomes perfected both *inter partes* and as against third persons as soon as it is embodied in a public document or the signatures of the parties on a private writing are certified by a notary and the date indicated.

Chile: Law no. 5687 on the contract of *prenda industrial* of 1935, art. 27 paras. 1 and 2.

The contract, in addition, requires registration.

Chile: Art. 27 para. 3.

It would seem, however, that such registration does not further increase the effects of the security interest as against third persons.

As regards third persons against whom the formal contract takes effect, a slight variation in wording is to be observed. While the cited provisions in *Chile, Egypt, Spain* and *Venezuela* speak of third persons generally, the *Italian* rule is limited to the creditors of the debtor.

Italy: Codice civile art. 1524 para. 1.

(b) *Formal contract as a preliminary formality*. In the vast majority of countries, a formal contract, whilst necessary, does not exhaust the legal requirements; it must be supplemented by other means of publication. Although the contract is thus a preliminary step towards the creation of a security interest, many legal systems impose strict requirements even as regards the contract; others, however, pay little attention to this. The statutory requirements primarily deal with the form of the contract, but occasionally also with its terms.

As regards *formalities* strictly so called, some countries demand a *public document*, that is a notarial act, even for "ordinary" security interests.

Lebanon: Loi of 1935, art. 4; *Peru*: Ley no. 2402 on registration of agricultural pledges of 1916, art. 7 para. 1; *South Africa* (province of Natal): Notarial Bonds (Natal) Act, no. 18 of 1932, s. 1-2; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 3 para. 1.

Japan requires a notarial deed only for the creation of a major security interest, namely the hypothecation of an enterprise.

Japan: Enterprise Hypothecation Law of 1958, art. 3.

Similarly, *Italy* and *Panama* draw a distinction based on the amount of the secured claim. *Italy* demands a public document or a private writing with certified signatures only for new machines with a purchase price of at least L. 500,000 (approximately $US 860) and *Panama* a public document only if the secured claim exceeds B. 4,000 (approximately $US 4,000); in other cases, a private writing with certified signatures suffices.

Italy: Law no. 1329 providing for the acquisition of new machines of 1965, art. 2 para. 1; *Panama*: Decreto Ley no. 2 on chattel mortgages of 1955, art. 21.

Many other countries, especially in Latin America, offer a choice between a public document and a *"qualified" private writing*, which appears as an equivalent to a public document. The equivalence depends upon either the presence of two witnesses or the certification of the signatures by a public official.

Brazil: Law no. 492 on rural pledges of 1937, art. 2; Decreto-Ley no. 1271 on pledges of industrial machines of 1939, art. 2 para. 1; *Chile*: Law no. 4702 on the instalment sale of movables of 1929, art. 2 para. 1; *Costa Rica*: Commercial Code of 1964, art. 537 para. 1; *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 11 para. 1; *El Salvador*: Commercial Code of 1970, art. 1154 (prenda); *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 5; *Tunisia*: Code de Commerce 1959, art. 238 para. 1 (mortgage of an enterprise).

In *Ecuador*, to have an effect similar to a public document, the signatures to a private writing must be acknowledged before a judge.

Ecuador: Commercial Code 1959, art. 581 para. 1; similarly *Venezuela*: Ley de hipotecas mobiliaria of 1973, art. 4.

Philippine law requires that the document be attested by two witnesses and supported by affidavits showing the *bona fides* of the parties.

Philippines: Chattel Mortgage Act of 1906, s. 5.

English law makes it mandatory that a statutory contract form be followed for a security bill of sale. The bill also requires attestation by at least one credible witness.

England: Bills of Sale Act 1882, ss. 9, 10.

In adopting the English bill of sale, most jurisdictions in the *British Commonwealth* seem to have attenuated the rigid English formalism. Typically they require one witness and an affidavit of good faith by the secured creditor, but do not demand recourse to the statutory contract form.

Canada: The (Uniform) Bills of Sale Act of 1928, revised 1955, amended 1959, ss. 5 (2), 6, 7, 8 (3), 19 and 20; *Kenya*: Chattel Transfer Ordinance 1930, ss. 5 and 15; *New Zealand*: Chattels Transfer Act 1924, ss. 5 and 20.

Statutory forms of contract are also prescribed in *Argentina, Paraguay* and *Uruguay*.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 6; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 10; *Uruguay*: Decreto containing regulations on the Law on Agrarian Pledge of 1918, art. 3; Decreto containing regulations as to the Law of Industrial Pledge of 1928, art. 11 para. 1.

The law in most other countries, especially in Europe, as also the more recent Latin American legislation, is, however, content with a *simple written contract*.

Brazil: Law no. 4 728 of 1965 (as amended by Decreto-Lei no. 911 of 1969), art. 66 § 1 (fiduciary transfer for security); *Colombia*: Commercial Code of 1971, art. 1 208 (prenda); *Czechoslovakia*: International Trade Code of 1963, ss. 163 and 324; *Denmark*: Tingslysningslov of 1926, § 47 para. 1; *France*: Loi relative au nantissement de l'outillage of 1951, art. 2 para. 1; Loi relative à la vente et au nantissement des fonds de commerce 1909, art. 10 para. 1; *Guatemala*: Civil Code of 1963, art. 884; *Lebanon*: Décret-Législatif no. 11 of 1967, art. 3 para. 1 (mortgage of enterprise); *Norway*: Law amending the legislation on pledges of 1895, § 3 para. 1; Law on mortgages for industrial credits of 1946, § 2 para. 1; *Panama*: Law no. 22 on agricultural pledge of 1952, art. 4; *Poland*: Civil Code of 1964, art. 308 para. 3; *Thailand*: Civil and Commercial Code s. 714; Registration of Machinery Act of 1971, s. 5 *juncto* Civil and Commercial Code s. 1299 para. 1; *United States*: Uniform Commercial Code s. 9-203 (1) sub (*b*).

It may moreover be assumed that in those States in which the registration of security interests is obligatory (*infra* s. 2.3.3.3) a written copy of the contract must be produced for registration even if this is not expressly provided.

A number of countries also lay down the basic details which a valid security agreement should include. This is most marked in those States which prescribe the use of a statutory form of contract (see *supra*). In other cases, the parties themselves are responsible for complying with the statutory requirements in a manner best suited to the circumstances. The list of requirements is particularly long in many Latin American countries. Typical of such requirements are:

(1) the parties' names, civil status, nationality, profession and domicile;

(2) amount, due date of payment and rate of interest for the claim secured;

(3) description of the goods encumbered enabling their precise identification, and the place where they are kept by the debtor.

See *Brazil*: Law no. 492 on rural pledges of 1937, art. 2 § 2; Decreto-Lei no. 1 271 on pledges of industrial machines of 1939, art. 2 § 1; *Colombia*: Commercial Code of 1971, art. 1 208; *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 4; *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 6; *Panama*: Decreto-Ley no. 2 on chattel mortgages of 1955, art. 7 and 16; Law no. 22 on agricultural pledge of 1952, art. 5; *Paraguay*: Decreto-Ley no. 896 on *prenda con registro* of 1943, art. 11; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 13; *Uruguay*: Decreto containing regulations on the Law on Agrarian Pledge of 1918, art. 3;

Venezuela: Decreto no. 491 on sales under reservation of ownership of 1958, art. 5 lett. a).

Certain additional requirements concerning other existing charges on the encumbered goods and insurance of these goods will be discussed below at the appropriate place (see *infra* s. 2.3.4.1 and 2.3.5).

Some of the more recent enactments have considerably shortened the statutory requirements and have reduced them in essence to details of the secured claim and the encumbered goods.

Brazil: Law no. 4728 of 1965 (as amended by Decreto-Lei no. 911 of 1969), art. 66 § 1; *Canada*: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, adopted in six provinces, s. 4 (1).

Even more lenient are those countries which insist only on a specific description of the encumbered goods.

France: Loi relative au nantissement de l'outillage et du matériel d'equipement of 1951, art. 2 para. 5; *Guatemala*: Civil Code of 1963, art. 884; *Philippines*: Chattel Mortgage Act of 1906, s. 7 para. 1; *United States of America*: Uniform Commercial Code s. 9-203 (1) sub (*b*).

A number of exceptional statutory requirements merit at least a brief mention. *Chile* and *France*, both countries with a *numerus clausus* of admitted security interests (see *supra* 2.3.2.3.1 sub *a*), with a view to preventing the abuse of certain devices provide for the mandatory inclusion in the contract of certain clauses. In *Chile* a contract for sale by instalments must contain a confirmation that the goods, the subject-matter of such a sale, have been delivered to the buyer.

Chile: Law no. 4702 on instalment sale of movables of 1929, art. 3.

In *France* the contract must contain a statement that the purchase money paid by the creditor is to be appropriated in payment of the purchase price of the goods acquired; the absence of this clause nullifies the contract.

France: Loi relative au nantissement de l'outillage et du matériel d'equipement of 1951, art. 2 para. 4.

Of some importance to international trade, especially in the case of long-term contracts, are rules regulating the *currency* in which the secured claim must be expressed. *Spain, Sweden, Thailand* and *Venezuela* expressly require this to be in the national currency.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 13 no. 4; *Sweden*: Law on enterprise mortgage of 1966, § 7; *Thailand*: Civil and Commercial Code s. 708; *Venezuela*: Ley de hipotecas mobiliaria of 1973, arts. 22 no. 3 and 53 no. 3.

This may well be the general rule, at any rate in those countries requiring registration.

Argentina, on the other hand, permits a charge (*prenda con registro*) securing an amount expressed in foreign currency provided that the security relates to the purchase price in respect of imported goods or a loan by an international finance institution of which Argentina is a member.

Argentina: Ley no. 12.962 on *prenda con registro* of 1947, as amended, art. 1 para. 2.

Before concluding this survey of the formal and substantive requirements of a contract creating a security interest, the reader should be reminded that the formal contract in all these cases serves merely as a preliminary step preceding some additional requirement—generally registration. A relevant question is whether the formal contract merely has this preparatory function or whether its conclusion in fact gives rise to *certain legal rights and duties*. On this question one seldom finds an answer in express statutory rules. Rather, this must be impliedly derived from those provisions which circumscribe the effect of registration (see *infra* s. 2.3.3.3).

Anticipating the results of this survey, one may state as a general principle, that subject to certain exceptions, registration is the condition precedent for giving effect to a security interest vis-à-vis third persons. It would seem to follow that, generally speaking, a security agreement otherwise in accordance with the appropriate requirements has the effect of giving rise to a legal relationship between the contracting parties even before registration.

Expressly *Argentina*: Ley no. 12.962 of 1947, art. 4; *Australia*: State of *Queensland*: Bills of Sale and other Instruments Act, 1955, s. 7 (1). The same results follow where, as between the parties, a written contract is prescribed (*Lebanon*: Décret-Législatif no. 11 of 1967 on mortgaging of an enterprise, art. 3 para. 1), or where this is required as a prerequisite for the enforcement of a security interest against the debtor (*United States*: Uniform Commercial Code s. 9-203 (1)).

But even as against third persons an unregistered security agreement which is otherwise proper may, in certain circumstances, be effective. This will depend on any applicable rules dealing with the protection of a security interest as against third persons. This protection does not always depend upon effective registration (for details, see *infra* s. 2.3.5 *et seq.*).

2.3.3.3 *Registration*

In most countries registration of a security interest is a prerequisite for giving full force and effect to it. In a few instances there is even a further step prescribed in addition to registration (*infra* s. 2.3.3.4). What follows cannot deal with the technical aspects of registration. Rather it is limited to some of the more substantive aspects, namely the duty to register, the place of registration, its duration, and its effect.

(a) *The duty to register* is rarely provided for as such. More usually it takes the form of an onus resting on the secured creditor, by describing the effects which follow registration. Instances where an express obligation to register, as opposed to an onus of this sort, is imposed, are:

Brazil: Decreto-Lei no. 1271 on pledges of industrial machines of 1939, art. 2 para. 1; *Finland*: Chattel Mortgage Act of 1923, § 1 para. 1; *El Salvador*: Commercial Code of 1970, art. 1155, deviating from other provisions of the Code; *Guatemala*: Civil Code of 1963, art. 912 (with certain exceptions); *Luxembourg*: Arrêté portant réglementation de la mise en gage du fonds de commerce of 1937, art. 4 para. 1; *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, art. 7 para. 2; *Poland*: Civil Code of 1964, art. 308 para. 3; *Sweden*: Law on enterprise mortgage of 1966, § 1; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 4.

In all these cases, the effect of registration must be gathered from the legal rules as to the protection of the security interest vis-à-vis third persons (*infra* s. 2.3.5 *et seq.*).

(b) *Place of registration.* Although this may seem on the surface a rather technical question, the place of registration raises various issues of practical importance. In particular the question whether the special needs of international trade have always been borne in mind merits attention. A survey of the existing systems shows three main approaches: registration at the location of the encumbered goods, at the debtor's domicile, and central registration. Occasionally these approaches are combined in various ways.

(1) Most countries prefer the *location of the encumbered goods*: if the goods are located in various places, multiple filing is usually prescribed.

Chile: Law no. 5687 on the contract of *"prenda industrial"* of 1935, art. 28; *Colombia*: Commercial Code 1971, art. 1210; *Ecuador*: Commercial Code art. 581 paras. 1 and 2; *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 11 para. 3-5; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 10 paras. 2-3; *Italy*: Codice civile art. 1524 para. 2 (for valuable machines); *New Zealand*: Chattels Transfer Act 1924, s. 5; *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 11 para. 1; *Paraguay*: Decreto-Ley no. 896 on *prenda con registro* of 1943, art. 12; *Peru*: Law no. 2402 on registration of agricultural pledges

of 1916, art. 7 para. 2 and art. 8; *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 69 and 70; *Venezuela*: Ley de hipotecas mobiliaria of 1973, arts. 81 and 82.

It is not clear whether a change of *situs* of the encumbered goods necessitates fresh registration. Only *Canada* expressly requires a fresh registration at the new location. This has to take place within 30 days after the secured creditor has received notice of the place to where the chattels have been removed.

Canada: (Uniform) Bills of Sale Act of 1928, revised 1955, amended 1959, s. 12; see also (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 4 (5).

(2) A considerable number of States require registration at the *debtor's domicile*, mostly in the case of sales under reservation of ownership.

Brazil: Decreto-Lei no. 1027 on the register of sales contracts with reservation of ownership of 1939, art. 1; *Denmark*: Tingslysningslov of 1926 (for chattel mortgage); *Ethiopia*: Civil Code art. 2387 para. 1; *Switzerland*: Civil Code art. 715 para. 1; *Turkey*: Civil Code art. 688.

A change in the debtor's domicile has no effect in *Canada*,

Canada: According to (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 4 (2) (a), the decisive factor is the buyer's residence at the time of making the contract,

while the *Swiss* and *Turkish* rules make applicable the debtor's present domicile, so that a change implies the necessity of re-registration. An additional problem is created if the debtor's domicile is abroad. *Canada* and the *Philippines*, which combine registration at the debtor's domicile with that at the *situs* of the goods (see *infra* (5)), rely in this case exclusively on the location of the encumbered goods.

Canada: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 4 (2) (b); *Philippines*: Chattel Mortgage Act of 1906, s. 4.

In the *American* Uniform Commercial Code which adopts in two of its alternative versions of s. 9-401 (1) the debtor's residence, the location of the goods is made the applicable criterion for non-residents.

United States: Uniform Commercial Code 1962, s. 9-401 (1) (second and third alternatives, see *infra*).

Denmark, which also relies exclusively on the debtor's domicile, provides in this case for registration in the country's capital.

Denmark: Tingslysningslov of 1926, § 47 para. 2.

In the other countries of this group it seems to be impossible to register security interests in goods held by a person living abroad. Whether this affects merely the possibility of registration or in fact excludes altogether the possibility of creating a valid security interest, is not clear.

(3) Registration at the *domicile of the secured creditor* is prescribed in *Brazil*, but for only one kind of security interest and in *Poland* for loans made by a State bank.

Brazil: Law no. 4 728 of 1965 (as amended by Decreto-Lei no. 911 of 1969), art. 66 § 1. *Poland*: Civil Code of 1964, art. 308 para. 3.

(4) Certain countries are satisfied with one registration in a *central registry*.

Australia: *New South Wales*: Bills of Sale Act, 1898-1938, s. 4 (1); *Victoria*: Instruments Act 1958, s. 33; *Western Australia*: Bills of Sale Act, 1899-1957, s. 8 (3); *Dominican Republic*: Law no. 1608 on conditional sales of movables of 1947, art. 2; *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 5.

(5) The three main criteria so far mentioned are sometimes also *combined* in various ways. The simplest combinations involve merely the *situs* of the goods and the debtor's domicile. In *Argentina*, a mortgage of fixed chattels is registrable at the place of location, whereas a floating charge at the debtor's domicile.

Argentina: Ley no. 12 962 on *prenda con registro* of 1947, as amended in 1963, arts. 12 and 16.

Canada, Kenya and the *Philippines* cumulate registration at the situs and the debtor's domicile.

Canada: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 4 (3) and (5); *Kenya*: Chattels Transfer Ordinance 1930, s. 7 (4); *Philippines*: Chattel Mortgage Act of 1906, s. 4.

In *England*, a chattel mortgage granted by a company is registrable centrally in London and in addition at the company's, i.e. the debtor's, office.

England: Companies Act, 1948, ss. 95 (1) (c) and 104.

A similar rule may be expected in all jurisdictions of the British Commonwealth which have adopted English company law.

In the second place, three criteria are combined, namely *situs*, debtor's domicile and central registration. All three are cumulated in *England* for bills of sale.

England: Bills of Sale Act, 1878, s. 13, and Bills of Sale Act (1878) Amendment Act, 1882, s. 11. These provisions have not been taken over in *Canada* and *Australia*, see *supra*.

The most complicated combinations occur in the *American* Uniform Commercial Code which provides the adopting states with no fewer than three alternative versions of the relevant provision. Further modifications have been separately introduced by a number of states. If we keep to the official text of UCC s. 9-401 (1), the states have the following choices: (1) generally central registration, but local filing for fixtures; only five small states have opted for this solution. (2) As in (1), but for various farming assets and consumer goods in the county of the debtor's residence; 24 states have adopted this version. (3) As in (2), but in addition to filing in a central registry at the debtor's place of business or residence also; 17 states have preferred this approach.

United States: Uniform Commercial Code 1962, s. 9-401 (1).

(4) Some states have stressed local filing at the debtor's residence.

(c) *Effective duration of registration.* In many countries a registered security interest automatically lapses at the expiration of a fixed period unless registration is renewed. In this sense registration offers a convenient way of terminating a security interest, and very many countries with systems of registration have availed themselves of this opportunity. There seems to be only one State where even an unregistered security terminates, namely *Venezuela*.

Venezuela: Decreto no. 491 on sales under reservation of ownership of 1958, art. 10 (time-limit of five years).

The life of a security interest after registration varies generally from one to 10 years; usually prolongations are possible. The very short period of *one year* (or 15 months) is often prescribed for agricultural mortgages, especially in *Australia*, on those on crops, livestock and wool.

Australia: mortgages for the next ensuing crop, etc. in *New South Wales*: Liens on Crops and Wool and Stock Mortgages Act of 1898, ss. 9 and 17; *Queensland*: Bills of Sale and other Instruments Act, 1955, ss. 33 and 13; *Victoria*: Instruments Act 1958, s. 79; *Western Australia*: Bills of Sale Act, 1899-1957, s. 40. See also *Costa Rica*: Commercial Code of 1964, art. 543 (fruits and other products). See generally *Australia*, state of *Victoria*: Instruments Act 1958, s. 44 (as amended by the Instruments (Bills of Sale) Act, 1958, s. 5); *Peru*: Decreto Supremo of 13 May 1953.

A *two-year* period is somewhat rare and applies again mostly to agricultural security.

Brazil: Law no. 492 on rural pledges of 1937, art. 7 para. 1 (as amended); *Uruguay*: Ley no. 5649 sobre prenda rural of 1918, art. 10.

Some countries specify a life-span of *three years*.

Australia: state of *Western Australia*: Bills of Sale Act, 1899-1957, ss. 14 and 15; *Brazil*: Law no. 492 on rural

pledges of 1937, art. 13 para. 1; *Canada*: (Uniform) Bills of Sale Act of 1928, revised 1955, amended 1959, s. 11 (1) and (7); (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 12 (1) and (7); *Dominican Republic*: Law no. 1608 on conditional sale of movables of 1947, art. 9; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 17 paras. 1-2 (five years for machines); *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 79 (six years for chattel mortgages).

The period is *four years* in two *Central American* countries and in *Venezuela*:

Costa Rica: Commercial Code of 1964, art. 542 (with the exception of fruits and other products); *Panama*: Decreto-Ley no. 2 on chattel mortgages of 1955, art. 7 last par. and art. 17 last par.; *Venezuela*: Ley de hipotecas mobiliaria of 1973, art. 85 (six years for chattel mortgages).

Many countries have settled for a five-year period.

Argentina: Ley no. 12 962 on prenda con registro of 1946, art. 23; *Australia*, states of *New South Wales*: Bills of Sale Act, 1898-1938, s. 5, and *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 12; *England*: Bills of Sale Act, 1878, s. 11; *France*: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 11; *Kenya*: Chattels Transfer Ordinance 1930, s. 10; *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 8; *New Zealand*: Chattels Transfer Act 1924, s. 14; *Switzerland*: Decree of the Federal Tribunal of 1939, art. 3; *United States*: Uniform Commercial Code of 1962, s. 9-403 (2).

In a few cases a time-limit of *10 years* is provided.

Denmark: Tingslysningslov of 1926, § 47 para. 3; *Finland*: Chattels Mortgage Act of 1923, § 15; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 28 para. 1 (as amended); *Luxembourg*: Arrêté portant réglementation de la mise en gage du fonds de commerce of 1937, art. 19.

Finally, one Latin American State expressly provides for registration to remain in force for an *unlimited* duration.

Chile: Law no. 5687 on the contract of *prenda industrial* of 1935, art. 30.

It may be assumed that countries other than those mentioned above do not fix a time-limit either.

(*d*) *Effects of registration.* Where a code imposes a duty to register, it is only in exceptional circumstances that the consequences of registration or non-registration are not set out (for a few exceptions, see *supra* (a)).

According to the legislative texts of most countries registration is a condition for the security interest to become effective vis-à-vis *third persons* in general.

Detailed references would be too numerous to indicate here. Suffice it to mention the countries: Argentina, Brazil, Canada, Chile, Colombia, Denmark, Dominican Republic, Ethiopia, Honduras, Japan, Lebanon, Mexico, Nicaragua, Panama, Philippines and Portugal.

A few statutes curtail the above principle by limiting it either to bona fide third persons,

Costa Rica: Commercial Code of 1964, arts. 542, 558; *Denmark*: Tingslysningslov of 1926, § 47 para. 1,

or to creditors of the debtor,

England: Companies Act, 1948, s. 95 (1),

or to bona fide creditors of the debtor.

Israel: Pledges Law, 1967, s. 4 (3).

Whether apart from creditors the category of third persons includes other persons, particularly purchasers, is doubtful; this will be examined later (*infra* s. 2.3.5.1 and 2.3.5.2). Only one country extends the effects of a registered security interest as against purchasers.

Italy: Codice civile art. 1524 para. 2 and Law no. 1329 providing for the acquisition of new machines of 1965, art. 3 para. 4 (reservation of ownership in machinery exceeding a certain purchase price).

A very flexible definition of third persons exists in the *United States*.

United States: Uniform Commercial Code of 1962, s. 9-301 to 9-304.

Some countries declare registration to be a condition precedent to the security interest taking effect even *inter partes*.

Ecuador: Commercial Code art. 581 para. 4; *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 12 para. 1; *England*: Bills of Sale Act, 1882, s. 8, see Heseltine v. Simmons, [1892] 2 Q.B. 547 at 552 (C.A.); *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, arts. 10 para. 2, 11 para. 1; Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 3; *Japan*: Enterprise Hypothecation Law of 1958, art. 4 para. 1; *Poland*: Civil Code of 1964, art. 308 para. 3; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 3 para. 4; *Switzerland*: Civil Code art. 715 para. 1; *Tunisia*: Commercial Code art. 239 para. 2 (enterprise mortgage); *Turkey*: Civil Code art. 688; *Uruguay*: Ley no. 5649 sobre prenda rural of 1918, art. 6; *Venezuela*: Ley de hipotecas mobiliaria of 1973, art. 4 para. 2.

Registration, however, has probably nowhere the effect of curing defects in the contract concluded between the parties, although this is only rarely expressly laid down.

Australia: state of *Queensland*: Bills of Sale and other Instruments Act 1955, s. 7 (3); *Costa Rica*: Commercial Code of 1964, art. 559; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 3 para. 5.

2.3.3.4 *Other formalities*

Formalities other than a formal contract or registration mainly take the form of marking the encumbered goods or of advertising the security interest.

(*a*) Marking of the encumbered goods with the secured creditor's name is usually either in addition to, or in place of, registration; rarely is it still the exclusive method of publication.

(1) Marking is required *in addition to registration* in a few scattered statutes concerning machinery. *France, Japan* and *Thailand* provide for the affixing of marks on the mortgaged machinery by a State office.

France: Loi relative au nantissement de l'outillage et du matériel d'equipement of 1951, art. 4; *Japan*: Construction Machinery Hypothecation Law of 1954, art. 4 para. 1 and art. 3 para. 1; *Thailand*: Registration of Machinery Act of 1971, Ministerial Regulation no. 2, art. 5 para. 2 *juncto* art. 3.

Cyprus also requires registration and marking for certain agricultural instruments, but leaves it to the debtor to affix the ironplate with the owner's name.

Cyprus: Agricultural Instruments (Hire-Purchase) Law of 1922, ss. 4, 6 and 7.

In a few countries special marks (other than the creditor's name) are also required for cattle which has been encumbered. A specific mark has to be attached to cattle in some countries and be included in the particulars presented for registration.

Ecuador: Commercial Code art. 582; *El Salvador*: Commercial Code of 1970, art. 1156 para. 2.

In Austria the validity of the special security interest in cattle is dependent upon the designated mark being affixed to the animal; the additional registration has only limited significance.

Austria: Regulation on credits for fattening cattle of 1932, §§ 1, 5 paras. 1, 7.

(2) A remainder of the earlier efforts to publicize security interests are those statutes which provide for *marking without registration*.

In some *Canadian* provinces the two methods are alternate. Reservations of ownership are exempt from the requirement of registration if the encumbered goods are marked with the

seller's name. Of the additional conditions, the most common is a duty imposed on the secured creditor to answer within a defined short period third party inquiries regarding the amount of the secured claim for the time being still outstanding.

See, e.g., the Conditional Sales Act of *Alberta*, s. 11; *New Brunswick*, s. 4; *Ontario*, s. 2 (5) (b); *Saskatchewan*, s. 5 (7) and (8).

In *Austria* heavy items the physical handing over to the creditor of which would be difficult, may be pledged without transfer, provided they are marked in some obvious way.

Austria: Civil Code of 1811, § 452.

In *Czechoslovakia* an item which is mortgaged must be physically marked so as to make it clear that it is mortgaged unless it is physically delivered to the mortgagee or a third person or unless the fact that it is mortgaged can be indicated on documents without which the item cannot be used, such as a motor vehicle.

Czechoslovakia: International Trade Code of 1963, s. 169.

(3) In *Italy* the validity of a security interest is made conditional upon the affixing of marks in the case of more valuable new machinery the purchase price of which exceeds L. 500,000 = about $US 860, registration in this case being optional.

Italy: Law no. 1329 providing for the acquisition of new machines of 1965, art. 1.

The Canadian province of *Manitoba* requires marking as the only means of publication.

Manitoba: Lien Notes Act, s. 2.

(*b*) The *advertising* of a security interest seems to be obligatory only in *Sweden* and then only for a "chattel mortgage".

Sweden: Regulation on "chattel mortgages" of 1845, as revised 1970, § 1. Publication must be in a newspaper circulating in the place of the debtor's residence; it must contain the names and professions of the parties, the date of the contract and particulars of the amount secured.

It may however be pointed out that in *England* and some other Commonwealth countries it is usual for commercial trade journals to publicize details of bills of sale which have been tendered for registration, so that in fact bills receive considerable publicity—at any rate in the commercial sector.

2.3.3.5 *Protection of third persons*

Many jurisdictions consider it necessary to protect third persons from the intended creation of a security interest. The various approaches are motivated by the desire to improve the chances of third persons of obtaining full satisfaction from the debtor's property in spite of it becoming encumbered by a security interest. Unfortunately, relatively little systematic thought seems to have been devoted to this aspect of security interests so far. In many countries, especially the highly industrialized ones, the pressure to accommodate the secured creditors has clearly prevailed.

One may distinguish a general protection of third persons from protection of specific interests of third persons.

(*a*) *A comprehensive protection* of third persons, especially of unsecured creditors of the debtor, is achieved through various general limitations on the creation of security interests.

Important general limitations are implicit in the various restrictions discussed earlier as to secured claims and admissible objects of security (*supra* 2.3.2.2 and 2.3.2.3).

Another form of indirect, but nevertheless comprehensive protection is provided by the fixing of a ceiling, expressed as a percentage of the value up to which certain objects may be encumbered. Such percentage limits are rather rarely imposed in the case of individual objects.

An exception for instance is the *Brazilian* provision permitting a charge up to 50% only upon products of swine-industry, Decreto-Lei no. 1625 of 1938, art. 8.

Slightly more frequent is a form of restriction by means of numerical limits in connexion with security interests created upon an amalgam of objects. Thus some countries permitting the mortgaging of an enterprise including the stock-in-trade limit the encumbrance on the latter to 50 per cent of its value.

Belgium: Loi sur la mise en gage du fonds de commerce ... of 1919, art. 2 para. 2; *Luxembourg*: Arrêté portant réglementation de la mise en gage du fonds de commerce of 1937, art. 2 para. 2; see also *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 22 para. 2, and *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 30 para. 2.

(*b*) The techniques designed to achieve protection of *specific persons* are of two kinds. One is a notice directed to the public at large, of the proposed registration. The other is the necessary consent of specific persons.

One form of a *general notice* is used in a special case by *Switzerland*. If the owner of a railway or shipping enterprise intends to mortgage his enterprise, he requires the consent of the Federal Council. The latter publishes the application in the Federal Gazette setting out a time-limit for objections. If an objection is filed, the objector is required to commence a lawsuit in the Federal Tribunal within 30 days.

Switzerland: Federal Law on hypothecation and forced liquidation of railway and shipping enterprises of 25 Sept. 1917, art. 2. It seems that in practice no objection has ever been filed!

Thailand has recently introduced the possibility of objecting to the mortgaging of machines; however, the details of this procedure, especially the admissible grounds therefore and the method for their ascertainment remain vague.

Thailand: Registration of Machinery Act of 1971, Ministerial Regulation no. 2 of 1971, art. 5 para. 2.

Very detailed, although slightly divergent rules have been enacted for bills of sale (chattel mortgages) in some *Australian* states. *New South Wales* and *Victoria* prescribe that a bill of sale may only be registered two weeks after an application for registration has been lodged,

New South Wales: Bills of Sale Act, 1898-1938, s. 5 E (1); *Victoria*: Instruments Act, 1958, s. 37,

while *Western Australia* requires a separate notice of intention to register a bill of sale in a statutory form.

Western Australia: Bills of Sale Act, 1899-1957, ss. 17 B and 17 C.

In *New South Wales* this procedure is limited to a trader's bills of sale, that is those where the debtor is a retail merchant.

New South Wales: ss. 5 E (1) and 5 B (1).

Publicity for the entries is in fact assured by credit agencies which supply daily listings of bills lodged for registration.

In all three states certain persons may file a *caveat* against the intended registration of the bill of sale.

Such an objection may be filed by any secured or unsecured creditor of the debtor in *Victoria* and *Western Australia*,

Victoria: s. 40; *Western Australia*: s. 17 H (3),

while in *New South Wales* only an unsecured creditor is entitled to object.

New South Wales: s. 5 G (1).

The parties to the bill of sale may thereupon summon the caveator before a judge to show cause why the caveat should not be removed. If the judge finds the caveator's claim to be well-founded he may order that registration of the bill of sale shall not take place until the debt due to the caveator is satisfied.

New South Wales: ss. 5 H (2), 5 I (1); *Victoria*: ss. 40-41; *Western Australia*: ss. 17 H (2), 17 J.

In *New South Wales* the judge has power upon an ex parte application to order the removal of a caveat on such terms as he thinks fit.

New South Wales: s. 5 J.

Australian procedure seems to be an interesting attempt at protecting the interests of the debtor's other creditors, especially the unsecured, against adverse effects that may arise upon the

creation of an intended security interest. Apparently, however, it is not used very much.

The second method of protecting third persons against the adverse effects of the registration of a security interest relies upon the *express consent* of specified persons, usually preceding secured creditors. This method amounts to a voluntary subordination (or postponement) of an existing security interest to a subsequent new security interest. It will therefore be more conveniently discussed in the general context of priorities (*infra* s. 2.3.5 *et seq.*).

2.3.3.6 *Conclusions*

The seemingly innocuous question of whether the creation of a security interest should be subjected to formalities, and if so, to which, has found an incredibly wide range of differing answers. Our concluding analysis can, of course, deal only with the more basic issues of this spectrum of varying solutions.

(*a*) *Functions of formalities.* Our analysis should be introduced by ascertaining the various functions which the major forms of formalities perform.

One peculiar task of the *formal contract* is to fix clearly and immutably the date of creation of the security interest in order to prevent subsequent fraudulent antedating by the creditor. Minimum requirements as to the contents of the contract may serve both parties as well as third persons, but the emphasis is probably on obtaining a registrable instrument. The obligatory use of a statutory form of contract will be designed for the debtor's protection.

Both *registration* of security interests and marking of encumbered goods are to warn third persons against the existence of security interests; they may also help to prevent unauthorized dispositions by the debtor.

(*b*) *Informality v. formality.* The first major controversial issue can be circumscribed by the question of whether statutory formalities are necessary at all or whether the experiences of the "informal" countries (*supra* 2.3.3.1) are outright negative. The question can probably best be answered by ascertaining how the major functions of formalities are solved in the informal countries.

The precise date of the creation of a security interest can only be ascertained by circumstantial evidence, which may sometimes be vague or contradictory. But fraudulent antedating is probably in most countries a relatively rare occurrence. Much more pertinent is the warning function of registration; this will be discussed *infra* (c).

The only recommendation for improving the informal system would be to require for the contract a simple writing, in accordance with general commercial practice. This would reduce the risk of fraud, without imposing an undue burden.

(*c*) *Formal contract v. registration.* As our survey has indicated, registration of security interests has spread over most parts of the globe and is today the most popular formality. How is the warning function of registration performed in countries requiring no formalities or merely a formal contract, but no registration? In these countries the warning function is largely performed by a general knowledge, at least in commercial circles, of which goods usually are bought on credit and which debtors are most likely to do so. Of course, this rather general knowledge requires additional ascertainment in each individual case. However, the modern systems of notice-filing do not offer much more precise information. Even though modern registration systems may be simple and cheap to operate,

Goode and Ziegel, *op. cit.*, 161

they require additional paper work, time, costs and offices.

Council of Europe, *Sales of Movables by Instalment and on Credit in the Member Countries of the Council of Europe* (cited as UNIDROIT) 253

The advantages to be gained thereby appear to be slim in general.

Do these considerations apply to international trade as well? Foreign creditors will often be ignorant about the credit habits of a particular country or of their specific debtor. However, foreign creditors will require local advice in any event. Without it they would not even know to which registration office they should turn in order to obtain precise information on their debtor's property. They will need local advice even more for the creation of the security interest if the encumbered goods are situated in the foreign debtor's country and therefore subject to its law (*infra* 3.2.1). Requisite local advice can easily be extended to cover the legal position of the debtor's property. Registration therefore is not necessary to facilitate international trade.

The scepticism heretofore expressed about registration does not, of course, imply any objection to existing schemes of registration. These are certainly most useful where they function properly.

(*d*) *The system of registration.* Of the numerous technical aspects of registration, the most important is that of the proper place of registration. Goode and Ziegel have convincingly shown the advantages of one central registration. Most important, it facilitates searches by third persons. It also avoids, on the part of the creditor, all doubts about the proper place of registration, and refiling in case of removal of the debtor's domicile or the location of the goods.

Goode and Ziegel, *op. cit.*, 162.

(*e*) *Marking and advertising v. registration.* If a public warning against existing security interests is desired, *marking* is clearly inferior. The more aggravating disadvantages of marking have been aptly summarized as follows: (1) the necessity of close, physical inspection of the goods to be encumbered; this is particularly burdensome if all the assets of an enterprise have been purchased or if distances between the business places of the parties are great. (2) The marks may be fraudulently (or negligently) removed by the debtor or they may wear off in the course of time.

See Goode and Ziegel, *op. cit.*, 160 who indicate additional objections. *Contra*: UNIDROIT 253, who does not, however, offer any discussion or reasons.

Also *advertising* is less effective than registration, although better than marking. It provides wide publicity at the time of creating the security interest, and interested persons such as credit agencies may use this as a basis for collecting permanent information. However, the emphasis is probably on avoiding conflicts with existing (secured or unsecured) creditors.

(*f*) *Interaction of registration and advertising.* The optimal form of publication, namely a combination of registration and advertising, is apparently nowhere prescribed. But in some countries private systems of collecting and publishing information on security interests seem, in effect, to combine both methods. Thus in some countries the registration of security interests is published in private trade journals. Conversely it may be expected that the prescribed advertisement of security interests will serve as the basis of private registers kept by credit agencies.

(*g*) *Issue of certificate.* Serious consideration should be given to the UNIDROIT proposal to extend the use of certificates, following the various models of certificates for motor vehicles (see *infra* 2.5.1.3).

UNIDROIT 253.

The certificate, be it official or private, is held by the secured creditor. Any disposition by a debtor who cannot produce the certificate is, since a purchaser under these circumstances is not *bona fide*, ineffective as against the secured creditor. Of course, this system works only with durable goods of some size that can be individualized. Also, it is exposed to the fraudulent practices of debtors who may be able to procure themselves substituted "clean" documents. In spite of these limitations the use of certificates should be seriously considered.

(*h*) *Final conclusion.* The preceding discussion has shown that no single formality for security interests is clearly superior to all others. A written security agreement, registration of the

security interest or its advertisement seem to be, generally speaking, on a *par*. The least cumbersome, but most effective publicity can probably be achieved by certificates over the encumbered goods and retained by the secured creditor.

On the other hand, a formalized written contract appears to be too formalistic, while marking of the encumbered goods does not provide sufficient formal publicity, if such is desired.

2.3.4 *Extension of security interests*

The extension of a security interest may affect its "active" or "passive" side: the debt secured may become increased by the admission of new claims under the cover of the security; or there may be alterations in, or additions to, the goods encumbered. We shall first deal with the "active" side because it is relatively simple, before proceeding to the more complicated questions of changes in the encumbered items.

2.3.4.1 *Extension of the secured claim*

Legislative rules permitting or prohibiting an extension of the secured claim are rare; but two examples of the opposing views can be furnished.

The *Israeli* Pledges Law of 1967 requires that, where the parties agree to enlarge the extent of the obligation, the security shall not cover any additional obligation unless an increase is effected in the encumbered goods for that purpose.

Israel: Pledges Law of 1967, s. 7 lett. (b).

In *Czechoslovakia, Hungary, Poland* and the *United States* the law expressly recognizes that a security interest may cover future advances or other value.

Czechoslovakia: International Trade Code of 1963, s. 162; *Hungary*: Civil Code of 1959, para. 253 (3); *Poland*: Civil Code of 1964, art. 306 para. 2;

United States: Uniform Commercial Code s. 9-204 (5); see also *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 14.

Unlike *Israel* there seems to be no restriction here concerning future advances subsequently agreed upon.

Future claims are also very liberally admitted by court practice in the *Federal Republic of Germany* and the *Netherlands*. In both countries it also seems possible to enlarge the secured obligation by a subsequent agreement without the need of furnishing additional security.

In other countries the situation is not entirely clear since information is not easily available.

2.3.4.2 *Extension of the encumbered goods*

An increase in the goods encumbered is, to a limited degree, admitted by the traditional rules on pledge, especially with regard to natural (or "legal") fruits or products. The demand for such extensions is, however, much stronger in the case of non-possessory security interests since the debtor as the holder of the encumbered goods may have a much greater interest in their disposal than has the creditor in the case of a pledge. In discussing these extensions one may distinguish three categories, namely substituted monetary claims, and additions to, and substitutions of, encumbered goods. A special group is formed by "complex units" of the goods charged (explained below, 2.3.4.3).

(*a*) *Substituted monetary claims.* Such substitutions may be either voluntary or involuntary on the part of the debtor.

The chief examples of *involuntary substitutions* are claims to the proceeds of an insurance against the loss of, or damage to, the encumbered goods; and other claims against a tortfeasor, an expropriating State or another debtor for reimbursement for loss of, or damage to, the charged goods. The statutory extension of a security interest to such monetary claims which arise involuntarily as substitutes of the destroyed or damaged goods meets with little resistance. Neither the debtor nor his creditors suffer a disadvantage since the extension does not cover additional items of the debtor's property, but something of value furnished by a third person. A number of countries therefore expressly extend the scope of the security interest to cover monetary claims substituting the originally encumbered items.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 3 para. 2; *Chile*: Law no. 4702 on instalment sale of movables of 1929, art. 7, and Law no. 5687 on the contract of prenda industrial of 1935, art. 31; *Colombia*: Commercial Code of 1971, art. 961 (for reservation of ownership); *Ecuador*: Commercial Code of 1959, art. 589; *Finland*: Chattel Mortgage Act of 1923, § 11; *Guatemala*: Civil Code of 1963, art. 902; *Israel*: Pledges Law of 1967, s. 9 lett. (a); *Japan*: Construction Machinery Hypothecation Law of 1954, art. 12; *Nicaragua*: Law on Agrarian and Industrial Pledge of 1937, art. 3 para. 2; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 17 para. 3; *Peru*: Law no. 2402 on Registration of Agricultural Pledges of 1916, art. 5; *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 5 and 62 para. 2 (the secured creditor may even pay the insurance premiums on which the debtor defaults, which are then covered by the security, art. 6); *Uruguay*: Ley no. 5649 of 1918 sobre prenda rural, art. 10; see also art. 19; *USSR*: Civil Code of the RSFSR of 1964, s. 200; *Venezuela*: Decreto no. 491 on sales under reservation of ownership of 1958, art. 12; Ley de hipotecas mobiliaria of 1973, art. 7.

In order that the secured creditor may be effectively assured the opportunity to avail himself of the most frequently substituted monetary claim, i.e. that for the insurance proceeds, some of the aforementioned statutes require the parties to state details of such insurances in their contract.

Argentina: art. 11 lett. f and art. 15 lett. f; *Chile*: Regulation for the special pledge register under the law on instalment sale of movables of 1929, art. 3 no. 8; Regulation for the register of "prenda industrial" of 1928, art. 3 no. 9; *Nicaragua*: art. 6 lett. e; *Paraguay*: art. 11; *Spain*: art. 57 no. 4; *Uruguay*: Decreto containing regulations on the Law on agrarian pledge of 1918, art. 3 para. 1; *Venezuela*: Ley de hipotecas mobiliarias of 1973, arts. 22 no. 6 and 59 no. 8.

Much less favoured are extensions of a security interest to monetary claims which may arise upon an *intentional* substitution of the encumbered goods. The most important example here is the claim to the purchase-price of the goods if the debtor should sell them to a third person. The reluctance on this point is apparently due to the belief that any such extension of necessity constitutes an implicit permission to the debtor freely to dispose of the subject-matter of the security. It is submitted that, although understandable, this assumption is wrong. But only few countries have overcome this misunderstanding. Some of these provide for a statutory extension of the security interest.

Colombia: Commercial Code of 1971, art. 1218 para. 2; *Costa Rica*: Commercial Code of 1964, art. 548 (fruits in season); *Japan*: Construction Machinery Hypothecation Law of 1954, art. 12; *Nicaragua*: Law on Agrarian and Industrial Pledge of 1937, art. 27 para. 1 (for unavoidable sale of perishable fruits); *United States*: Uniform Commercial Code s. 9-306 (2) — (5).

And one other country sanctions such extension only where the parties have so agreed.

Federal Republic of Germany: standing court practice.

(*b*) *Additions to, and substitutions of, encumbered goods.* As regards *additions* to encumbered goods, these may take at least two different forms, namely fruits or progeny, and after-acquired goods.

An extension of a security to fruits or progeny of animals is provided by statute in a few agricultural states.

Australia: "stock" (i.e., cattle) mortgages in the states of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 27 (1); *Victoria*: Instruments Act 1958, s. 75; *Western Australia*: Bills of Sale Act, 1899-1957, s. 38; *Kenya*: Chattels Transfer Ordinance 1930, s. 25; *Mexico*: Ley gen-

eral de títulos y operaciones de crédito of 1932, art. 322, 324 (certain special credits); *New Zealand*: Chattels Transfer Act 1924, s. 29. See also *Czechoslovakia* International Trade Code of 1964, s. 159.

The status of *after-acquired items* (apart from substituted goods) is less certain since later acquisitions usually lack any connexion with the originally encumbered goods. A few legal systems expressly exclude in general from the coverage of the security any assets which have been acquired by the debtor subsequent to the creation of the security interest.

Australia, state of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 21; *England*: Bills of Sale Act (1878) Amendment Act, 1882, s. 5; *Kenya*: Chattels Transfer Ordinance 1930, s. 18; *New Zealand*: Chattels Transfer Act 1924, s. 24 (1).

The principle however is merely established in order that certain exceptions may be grafted thereon. One exception, more apparent than real, relates to a purchase-money loan with which the goods to be encumbered are to be acquired in future.

Australia, state of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 21 first proviso; *Guatemala*: Civil Code of 1963, art. 911; *New Zealand*: Chattels Transfer Act 1924, s. 24 (2).

Much more important is another exception extending the security interest to goods of the same class brought to the place or business premises where, according to the agreement of the parties, the originally encumbered goods are being kept. Some jurisdictions provide for such an extension by statute, subject to any agreement to the contrary between the parties.

Australia: generally state of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 21 second proviso sub (ii) and (iii); for "stock" (i.e., cattle) mortgages: *Queensland*, s. 27 (1); *Victoria*: Instruments Act 1958, s. 75; *Western Australia*: Bills of Sale Act, 1899-1957, s. 38; *Kenya*: Chattels Transfer Ordinance 1930, s. 25 (1) for stock (of animals); *New Zealand*: Chattels Transfer Act 1924, s. 26 lett. (c) and 29 for machines, vehicles, implements and stock (of animals).

The trend of present-day law would seem to be more reserved. The parties are empowered to conclude an appropriate agreement, but this is a necessary prerequisite to the extension.

Australia, state of *Western Australia*: generally, apart from "stock" mortgages, s. 7 A; *Federal Republic of Germany* and the *Netherlands*: judicial practice, *United States*: Uniform Commercial Code s. 9-204 (3) with exceptions as to crops and consumer goods in subs. (4).

The *substitution* of encumbered goods poses quite different problems, which are somewhat related to voluntarily substituted monetary claims (*supra* (*a*)). Should the debtor be enabled to replace worn-out machinery, the subject-matter of a security interest, by new or modern equipment? The interests at least of the debtor and secured creditor are clearly in favour of such a solution. A similar question arises in a slightly different context if the goods encumbered consist of cattle, crops or raw materials which the debtor intends to use for producing finished or semi-finished goods. Such substitution would seem to be not only in the interest of the parties, but also beneficial to any interested third person.

As one would expect only a few countries provide expressly for the extension of a security interest to substituted goods, subject to contrary agreement by the parties.

Australia: generally and for cattle in the state of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 21 second proviso sub (i) and s. 27 (1); *Brazil*: Law no. 492 on rural pledges of 1937, art. 12 §§ 2, 3 providing however that to become effective against third persons, a corresponding amendment of the contract be made; Decreto-Lei no. 1697 extending the provisions of Decreto-Lei no. 1271 of 1939, art. 2, requiring the secured creditor's written consent; *England*: Bills of Sale Act (1878) Amendment Act, 1882, s. 6 sub (2); *Kenya*: Chattels Transfer Ordinance 1930, s. 20 lett. (b) for certain items; *Mexico*: Ley general de títulos y operaciones de crédito of 1932, art. 335; *New Zealand*: Chattels Transfer Act 1924, s. 26 lett. (b) for certain items; *Uruguay*: Ley 8 292 of 1928 on prenda industrial, art. 2 no. 3.

In one country the substitution of fungible goods by assets of the same class may be agreed by the parties.

Guatemala: Civil Code of 1963, art. 909.

In others, such agreement is presumed.

Honduras: Commercial Code of 1950, art. 1294; to like effect *Kenya*: Chattels Transfer Ordinance 1930, s. 42 and Third Schedule no. 4; *New Zealand*: Chattels Transfer Act 1924, s. 50 and Fourth Schedule no. 4.

In a class of their own are substitutions of encumbered materials with products. In particular a number of Latin American states provide for this kind of extension of a security interest.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 3 para. 2, subject to any contrary agreement between the parties, art. 8 para. 2; *Chile*: Law no. 5 687 on the contract of "prenda industrial" of 1935, art. 25 para. 2; *Colombia*: Commercial Code of 1971, art. 1218 para. 2; *Mexico*: Ley general de títulos y operaciones de crédito of 1932, arts. 322, 324; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 20 para. 1, requiring the previous consent of the secured creditor; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 8 para. 2.

It goes without saying that a statutory or valid contractual clause providing for after-acquired property will cover substituted goods.

2.3.4.3 *"Complex units" of charged goods*

Instead of permitting additions to, or substitutions of, individual encumbered goods or claims, a legislator may take another course of action in order to achieve the extension of a security. He may empower a debtor to encumber a number of items designated as a unit and treated collectively as a fluid compound in which the individual components may fluctuate (referred to herein as a "complex unit"). A major obstacle to such an arrangement is the principle recognized in most legal systems of admitting the creation of rights *in rem* as a rule only in specific individual items. Any exception to this principle usually requires special legislative authority. By permitting the creation of a security interest in a complex unit, the legislator often impliedly allows the substitution and addition of individual items in the complex unit. He also impliedly grants the debtor power to dispose of the encumbered items.

The complex units thus created by legislation have taken different forms, and each must be analysed separately in order to assess the degree to which it implies the substitution of encumbered goods.

Probably the simplest case, and a rather special one, is the Spanish rule on collections of works of art and of historical works which may be encumbered as a whole.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 54, mentioning expressly pictures, sculptures, porcelain and books; similarly *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 51 first paragraph.

This example is rather unique because of its non-commercial context. Typically, complex units of goods are only found in the business field.

The first model of a commercial nature is the *Argentine* floating pledge (*prenda flotante*). Its subject-matter is goods and raw-materials belonging to a commercial or industrial firm, provided, however, that the secured claim does not exceed a maximum duration of 180 days. The security interest covers the goods produced by the transformation of the originally encumbered goods as well as those acquired by the debtor in replacement of them.

Argentina: Ley no. 12 962 on prenda con registro of 1947, arts. 14-16.

The restriction of this security interest to short-term advances and the little practical use that is being made of it prove its limited utility.

The second commercial model is the *Finnish* chattel mortgage. It may cover machines, inventory, raw-materials, and finished and semi-finished products and also animals and agricultural products of industrial, certain artisanal, or agricultural enterprises.

Finland: Chattel Mortgage Act of 1923, § 2.

All items of the above classes are subject to the security, as long as they are kept on the business premises or in another specifically registered location (§ 4 par. 1). This rule obviously also embraces additions and substitutions. The statute expressly permits the debtor to withdraw items from the ambit of the charge, provided this is done in the regular course of business or for the purpose of replacement or if the residual goods are obviously sufficient to satisfy the secured creditor (§ 4 par. 2).

The connexion between encumbered goods and a specific business enterprise is even more emphasized in the third commercial model. Here it is a *business undertaking* as such which is encumbered. One may distinguish in essence two approaches which are derived from the French enterprise mortgage on the one hand and the English floating charge on the other.

The *French* enterprise mortgage is more restricted in scope. It has been adopted, with certain variations, by a number of Latin, African and Asian countries and one may distinguish between two types, one narrow and the other more liberal.

The narrow type is found especially in *France* itself. The French law of 1909 in the first place circumscribes the goods which may be covered: first, the business sign and trade name; second, the rights under a lease (of the business premises); third, the goodwill and custom; fourth, the commercial installations; and fifth, industrial property rights and copyright.

France: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 9 para. 1. Corresponding provisions in *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 9 para. 1; *Lebanon*: Décret-Législatif no. 11 of 1967, art. 23 para. 1; *Tunisia*: Commercial Code of 1959, art. 237 para. 1.

This catalogue emphasizes incorporeal values; it excludes especially merchandise (stock in trade),

Expressly *Lebanon* art. 23 para. 4

and money claims. The emphasis on incorporeal values is underlined by the presumption that only the first three items of the catalogue are deemed to be included in an enterprise mortgage, unless the parties expressly and specifically include additional items.

France: art. 9 para. 3; *Egypt*: art. 9 para. 2; *Lebanon*: art. 23 para. 2; *Tunisia*: art. 237 para. 3. In *Denmark* the lessor of business premises may mortgage the inventory and, in case of an agricultural lease, also the animals, crops and other products, Konkurslov of 1872, § 152 para. 2.

Somewhat broader is the coverage of enterprise mortgages in *Belgium*, *Luxembourg* and probably also *Argentina*. These countries do not enumerate the items that may be charged, but offer merely an illustrative list from which the parties may deviate and to which apparently they may also add.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 11 lett. (*d*); *Belgium*: Loi sur la mise en gage du fonds de commerce of 1919, art. 2 para. 1; *Luxembourg*: Arrêté portant réglementation de la mise en gage du fonds de commerce of 1937, art. 2 para. 1.

The latter is true in particular for merchandise which, while primarily excluded

Expressly *Argentina* art. 11 lett. (d),

can be included by the parties, although subject to limitations in some countries.

Belgium: art. 2 para. 2, and *Luxembourg*: art. 2 para. 2: up to 50 per cent of its value.

Considerably broader in its coverage is the modern, liberal type of enterprise mortgage. It comprises or may comprise, apart from incorporeal interests such as trade name, lease, goodwill and industrial property rights, tangible values such as installations, machines, raw-materials and merchandise.

Colombia: Commercial Code of 1971, arts. 532 para. 2, 516; *El Salvador*: Commercial Code of 1970, art. 557; *Guatemala*: Commercial Code of 1970, art. 657; *Honduras*: Commercial Code of 1950, arts. 648, 1315; *Mexico*: Ley general de instituciones de crédito of 1941, art. 124; *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 20-22; *Sweden*: Law on enterprise mortgage of 1966, § 4; *Venezuela*: Ley de hipotecas mobiliaria of 1973, arts. 27-30.

In most countries, the catalogue of chargeable items comprises money claims also, except in Spain. But only few statutes provide expressly for the regrouping of the encumbered goods. A *Spanish* provision includes implicit permission for the debtor to sell his merchandise,

Spain: art. 22 para. 2; also *Venezuela*: art. 30 para. 2

but he is obliged (vis-à-vis the secured creditor) to maintain the quantity and value at the same level as specified in the contract with the creditor. In *Mexico*, the debtor is empowered to dispose of money claims and to substitute them in the ordinary course of business, unless the parties have agreed otherwise.

Mexico: art. 124 para. 1.

Only *Colombia* expressly provides that encumbered assets which have been alienated or consumed shall be deemed to be replaced by those which, in the course of business, have been produced or acquired.

Colombia: Commercial Code of 1971, art. 532 para. 3.

It may be assumed, however, that a corresponding rule applies in all the other countries.

The *English* floating charge, a most remarkable "invention" of business and judicial practice and essentially uncodified to this day, is considerably broader than its French and Latin counterparts. It has been taken over by all former and present members of the British Commonwealth which have adopted British company law. It is available only to incorporated companies, and not to individuals. The debtor company may create, apart from a fixed charge which comprises specific items a charge covering the whole business undertaking and all present and future assets of any kind. In the life of a floating charge two phases have to be distinguished. At the beginning and as long as it "floats", the charge is not yet a true right *in rem* encumbering any specific item of the business assets. Consequently the company is free to dispose of its assets in the ordinary course of business, and other creditors may levy execution on them. It is only upon the happening of the events specified in the security agreement (which generally includes the levy of execution by another creditor), or if the secured claim falls due and the creditor appoints a receiver or if the company becomes insolvent, that the charge "crystallizes' and becomes a true right *in rem*.

England: See *Gower*, The Principles of Modern Company Law (ed. 3, 1969) 78-80, 420-425.

The English model has inspired *Japanese* legislation. The Japanese Law of 1958 follows in most respects the English rules, although "translated" into a civil law system.

Japan: Enterprise Hypothecation Law of 1958.

Subject-matter of the security are the total assets of a limited company from time to time belonging to the company "as a single unity".

Art. 1 para. 1; art. 2 para. 1.

The right qualifies as a right *in rem* (art. 1 para. 2), but is subordinated to specific rights *in rem* and general and specific preferences (arts. 6 and 7). Enforcement by the secured creditor is subject to court supervision and is effected by a receiver appointed by the court.

Arts. 19-21, 30-36.

2.3.4.4 *Conclusions*

The problems surrounding the extension of security interests affecting either the secured claims or the encumbered goods, are of relatively recent origin and have therefore not yet been very well considered. Accordingly, the illustrative rules adduced in the foregoing discussion represent a smaller number of countries than in other fields. Due to this narrower basis of comparison the following conclusions are also of a more tentative nature.

(*a*) *Extension of the secured claim.* The restrictive *Israeli* rule under which an extension of the secured obligation must be made up by an increase in the encumbered goods, is not persuasive. It is apparently based on the idea that the secured claim and the security ought to be balanced, but for good reason this idea is not recognized anywhere else in the law of security interests and it is equally unacceptable here. The appreciation of the interests of debtor and creditor is definitely best left to themselves. As regards third persons, especially other creditors, it is more than doubtful whether their interests are promoted by an invitation to encumber more goods. Extensions of the secured claim should therefore not be restricted.

(*b*) The *involuntary substitution of monetary claims* for the loss of, or damage to, encumbered goods does not meet with objections from any side. The widespread and increasing recourse to insurance makes it desirable to lay down an express rule on such substitutions, especially with respect to the insurance claims themselves.

(*c*) An *intentional substitution of monetary claims* for the disposition of encumbered goods poses some difficult problems. In the first place it should be clearly spelt out that any statutory or contractual provision granting such a substitution does not imply an otherwise unavailable permission to the debtor freely to dispose of the encumbered goods. The substitution takes place if and when the debtor has disposed of the encumbered items, irrespective of whether the disposition was permitted or not.

Difficulties are bound to arise if the substituted monetary claim, especially that for the purchase-price of the encumbered goods, had already been charged by the debtor prior to his disposition of the encumbered goods. The resulting conflict between two secured creditors arises frequently since the assignment of present and future claims of money is very popular in many countries. The proper resolution of the conflict is controversial and is outside the scope of this paper.

(*d*) *Additions to the encumbered goods.* The extension of the security interest to *fruits or progeny of animals* gives a windfall to the secured creditor and diminishes the free assets available to the debtor's unsecured creditors. While there is certainly reason to allow a contractual extension of this nature, a statutory extension appears to be too favourable for the creditor.

The same considerations militate against a statutory extension of the security interest to *after-acquired goods* of the debtor.

(*e*) *Substitutions of encumbered goods* pose problems similar to those raised by intentionally substituted monetary claims (*supra* (*c*)). However, their factual importance is less pressing since the substitution of goods for goods is less attractive for the parties and is therefore likely to be better justified economically. The replacement of worn-out encumbered machinery or the substitution of the products for encumbered raw materials does not seem to meet any objection.

In the context of these substitutions it would even seem permissible to imply a permission to effect such substitutions from an express statutory or contractual provision regulating the effects of a substitution.

There is a risk of conflicting security interests in the substituted items. However, the general rules on the effects of a security interest against third persons, especially against other secured creditors (see *infra* 2.3.5.3) supply a proper solution to such conflicts.

While detailed statutory rules on the subject do not appear to be indicated, legislation should expressly empower the parties to make corresponding arrangements where their right to do so is doubtful.

(*f*) *Complex units of charged goods.* The institution of "complex units" like the business enterprise is the most refined form of a global security interest as distinct from one on specific items. It implies the debtor's power to dispose of the charged goods and to substitute or add new items. One may probably say that such complex units are the extreme consequence of the idea of a non-possessory security interest, a consequence accepted so far in few instances only.

It would seem that the English distinction between two phases in the life of a floating charge, namely pre-crystallization and crystallization, is sound. Crystallization, in effect, amounts to the enforcement of the security interest by the secured creditor.

Before the enforcement has been effected, the debtor has power, on the one hand, to dispose of the encumbered assets, and on the other to extend the security interest to new assets acquired in substitution of, or in addition to, those originally encumbered. It may be wise to restrict these two powers, in the interest of the secured creditor and of third persons, respectively. The secured creditor need not suffer a permanent depletion of the encumbered items; this could be prevented by a flexible formula admitting only dispositions of the debtor in the ordinary course of his business or by demanding that a stated value must be maintained. Executions by other creditors of the debtor should also be permitted. On the other hand, in the interest of third persons, especially the debtor's unsecured creditors, a restriction should also be placed on additions to the complex unit; a maximum limit to be determined by the parties should not be exceeded. The latest additions exceeding this limit would not be affected by the security interest.

If, upon the happening of certain specified events, the secured claim falls due, the security interest crystallizes. Thereafter, the debtor has no longer power to dispose of, and execution by other creditors may not be levied on, the encumbered assets. (Of course, the crystallized global security interest ranks after rights which the debtor may have validly created, or executions levied, before crystallization.)

To which economic units the above rules should be applied, must be left to the decision of the national legislations. It would seem that business enterprises should be selected in the first place.

2.3.5 *Protection against third persons*

The main purpose of security interests is to achieve for the secured creditor preferential treatment in obtaining satisfaction from the encumbered goods of the debtor, as against the competing claims of third persons. For this reason the legal value of a security interest is directly proportional to the protection which it affords as against the claims of the various categories of third persons. The four most important categories of competing third persons will be considered in turn here, viz. unsecured creditors of the debtor, purchasers from the debtor, secured creditors of the debtor whose security rests on movables, and real estate mortgagees of the debtor.

2.3.5.1 *Protection against unsecured creditors*

The broadest category of persons against whom a secured creditor seeks protection are the debtor's general creditors, i.e. those who have neither a contractual security interest nor a statutory privilege securing their claims.

In most countries the protection afforded the secured creditor against the claims of the debtor's unsecured creditors is determined by rules regarding security interests in general, and by those on execution by way of attachment and on bankruptcy. Of these three sets of rules, only the former can be analysed in detail here since limitations of time and space do not permit an exhaustive analysis of the specific rules on execution and bankruptcy.

The two main avenues of attack for the debtor's unsecured creditors are by execution on the property of the debtor and by participating in his bankruptcy. The extent of the protection

granted to the secured creditor in these two types of proceedings, will be examined in turn.

(*a*) Against *execution* on the encumbered goods of the debtor, the secured creditor will in general be protected. However, the extent of this protection varies, frequently depending on the legal form in which the security interest has been created (see *supra* 2.1.2).

Where it has been cast into the form of ownership (reservation of ownership by the creditor or security transfer of ownership to him), this usually bars executions by the debtor's unsecured creditors. The bar is generally not automatic, but depends upon the secured creditor's objection.

Reservation of ownership: *Brazil*: see Mertens *op. cit.*, p. 85; *Colombia*: Commercial Code of 1971, art. 964; *Dominican Republic*: Law No. 1608 on conditional sale of movables of 1947, art. 10; *Federal Republic of Germany*: see *Devel*, Allemagne p. 14; *Italy*: see *Mertens* p. 153-154; *Poland*: Civil Code of 1964, art. 590; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, art. 20 para. 1.

Security transfer of ownership: *Germany*: judicial practice; *Sweden*: Regulation on the sale of goods which the buyer leaves in the seller's possession of 1845, § 1.

Where the security interest takes the form of a mortgage (as a limited right in another's good), the secured creditor cannot object to seizure of, and execution against the encumbered good. He is limited to a claim for priority in the distribution of the proceeds of sale.

Finland: Chattel Mortgage Act of 1923, § 12; *Mexico*: Civil Code of 1928, art. 2873 para. 1; *Peru*: Ley No. 6 565 on instalment sales of 1929, art. 8; *Sweden*: Law on enterprise mortgage of 1966, § 13 para. 1; *Venezuela*: Ley de hipoteca mobiliarias of 1973, art. 68.

Exceptionally in case of reservation of ownership *Switzerland*: see *Mertens* pp. 202-203.

The secured creditor thus loses his security interest in the encumbered goods and is perforce merely entitled to a preferential share in the distribution of the proceeds (which may or may not cover his claim).

An interesting alternative to the seizure and sale of the encumbered goods is provided in *New Zealand*. The execution officer may instead sell the judgement debtor's interest in the encumbered goods. In this case the secured creditor may take possession of these goods, but holds them in trust for the purchaser of the debtor's interest, subject of course to his own prior interest.

New Zealand: Chattels Transfer Act 1924, s. 47; see also *Kenya*: Chattels Transfer Ordinance 1930, s. 39.

However, it appears doubtful whether this procedure is of great practical importance since there will hardly be a market for the sale of such interests.

(*b*) In the debtor's *bankruptcy*, the protection of the secured creditor is even more questionable since he faces not only one execution creditor, but competes with all the unsecured creditors of the debtor. Nevertheless, most countries protect the secured creditor effectively while certain countries deny protection. One may distinguish between three types of positive and one type of negative protection.

Comparable to the bar against execution by an unsecured creditor is the secured creditor's right to *claim the encumbered goods* from the bankrupt debtor's estate. This claim is in many countries granted irrespective of the legal form which the security interest takes.

For reservation of ownership: *Brazil*: see Mertens, *op. cit.*, p. 85; *Federal Republic of Germany*: see Devel, Allemagne pp. 14-15; *Italy*: see Mertens *op. cit.*, pp. 153-154; *Japan*: see Devel, Japon p. 5 quoting the Bankruptcy Act of 1922, art. 87; *Lebanon*: see Devel, Liban p. 4; *Netherlands*: see Devel, Pays-Bas p. 6; *Switzerland*: see Mertens, *op. cit.*, p. 204;

For security transfer of ownership: *Brazil*: Decreto-Lei No. 911 of 1969, art. 7; *Sweden*: Regulation on the sale of goods which the buyer leaves in the seller's possession of 1845, § 1;

For mortgages: *Brazil*: Law No. 492 on rural pledges of 1937, art. 3 § 1; *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 26; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 10 para. 2.

In cases of reservation of ownership the secured creditor's right of repossession may in some countries in effect be emasculated by an objection made available to the trustee in bankruptcy. The latter may elect between performing the contract of sale concluded between secured creditor and debtor or cancelling this contract.

See *Austria*: Konkursordnung of 1914, as amended, § 21; *Denmark*: Konkurslov of 1872, § 16 par. 1 No. 2; *Federal Republic of Germany*: Konkursordnung of 1877, as amended, § 17; *Sweden*: see Devel, Suède p. 6; *Switzerland*: see Devel, Suisse p. 16; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, arts. 17-18.

Only where the trustee elects to cancel the contract does the secured creditor remain entitled to reclaim the encumbered goods. If, on the other hand, the trustee elects to perform the contract, the secured creditor is not entitled to reclaim the goods and is relegated to an unabridged claim for the unpaid purchase-price from the estate. Thus, in effect, the secured creditor obtains full satisfaction.

Some countries deny the secured creditor a right of repossession. The encumbered goods are left in the bankrupt estate and liquidated, but the secured creditor may claim priority in the proceeds of sale, without being relegated to a dividend. This corresponds to the treatment of mortgages upon execution.

Chile: Law No. 4702 on instalment sale of movables of 1929, art. 32; *Sweden*: Law on enterprise mortgage of 1966, § 13 para. 1.

For a security transfer of ownership, *Federal Republic of Germany*: see Devel, Allemagne p. 26.

Some countries deny protection to certain security interests for which no registration has been provided. These security interests have no effect in the debtor's bankruptcy. This is especially the fate of a reservation of ownership in France and certain countries inspired by France.

France: see Devel, France pp. 4-5; *Belgium*: see Sepulchre, Belgique p. 3; *Egypt*: see Devel, Egypte p. 3; *Luxembourg*: see Sepulchre, Luxembourg p. 1.

Legally speaking, a security interest which does not withstand the severe test of bankruptcy, can hardly qualify as a true and full security. It should be noted, however, that under the laws of the above-mentioned countries as a rule only merchants can go bankrupt. Therefore security interests in goods sold to individual consumers cannot be affected.

2.3.5.2 *Protection against purchasers*

The term "purchasers" must be understood in a wide, generic sense. It comprises not only a buyer who by virtue of a sales contract purports to obtain ownership in the encumbered goods, but also a person who intends to acquire a limited right, such as a (second) mortgagee.

See the broad definition of "purchase" in the *United States* Uniform Commercial Code s. 1-201 (32).

However, in the forefront of practical concern and most legislative rules stands a buyer of the encumbered goods, and it is with him that we shall deal primarily. Conflicts with certain other secured claims will be discussed separately (*infra* 2.3.5.3-4).

The debtor is usually (unless he is a dealer trading in the encumbered goods or the encumbered goods form a "complex unit", see *supra* 2.3.4.3) prohibited from disposing of the encumbered goods.

See, e.g., *Argentina*: Ley No. 12 962 on prenda con registro of 1947, art. 9; *Brazil*: Decreto-Lei No. 1271 on pledges

of industrial machines of 1939, art. 3; *Colombia*: Commercial Code of 1971, art. 957; *Panama*: Decreto Ley No. 2 on chattel mortgages of 1955, arts. 6 and 15; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 4; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, art. 9; Ley de hipotecas mobiliaria of 1973, art. 6.

This prohibition is, however, lifted if a sale of the encumbered goods provides the means for repaying the secured loan. Some *South American* statutes provide so expressly, sometimes adding precautions designed to ensure the speedy transfer of the proceeds of sale to the secured creditor.

Guatemala: The sale must be against cash, must cover the whole amount of the outstanding indebtedness, and must be previously notified to the secured creditor. After sale, payment must be effected within 24 hours and upon immediate notice to the secured creditor (Civil Code of 1963, art. 914). See also *Panama*: Law No. 22 on agricultural pledge of 1952, art. 12 para. 1; *Peru*: Law No. 2402 on registration of agricultural pledges of 1916, art. 9; *Uruguay*: Ley No. 5 649 sobre prenda rural of 1918, art. 16 (delivery of the goods only after payment to the creditor); *Venezuela*: Ley del Banco agricola y pecuario of 1946, art. 58; Regulations of the Corporación Venezolana de Fomento of 1947, art. 38.

Panama and *Peru* also envisage the case where the proceeds of sale cover part only of the secured claim. Here the secured creditor has a pre-emptive right to acquire the encumbered goods for the agreed price.

Panama: art. 12 para. 2; *Peru*: art. 9.

Argentina expresses as a condition what in most countries is the consequence of an unauthorized disposition, i.e. the security interest (and also the secured claim itself!) must be taken over by the buyer.

Argentina: art. 9.

An unauthorized disposition of the encumbered goods by the debtor is, generally speaking, in most countries without effect as against the secured creditor. Under general rules this would mean that the buyer may have acquired a good title to the encumbered items, but subject to the secured creditor's continuing security interest.

Australia, Western Australia: Bills of Sale Act, 1899-1957, s. 27; *Czechoslovakia*: International Trade Code of 1964, s. 327; *Dominican Republic*: Law No. 1608 on conditional sale of movables of 1947, art. 10; *El Salvador*: Commercial Code of 1970, arts. 1041 para. 2 and 1156 para. 2 sub III; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 22 para. 1; Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 7 para. 2 (provided, the optional marking has been affixed, see *supra* 2.3.3.4); *Guatemala*: Civil Code of 1963; art. 892 para. 2; *Italy*: Law No. 1329 providing for the acquisition of new machines of 1965, art. 3 para. 4; *Japan*: Construction machinery hypothecation law of 1954, arg. arts. 19 and 20; *USSR*: Civil Code of the RFSFR of 1964, s. 202; see also *United States*: Uniform Commercial Code, s. 9-307 with s. 1-201 (9).

However, where the secured creditor's interest is based upon ownership, the purchaser does not acquire a good title.

See for *English* and *Commonwealth* countries' hire-purchase: Goode and Ziegel, *op. cit.*, 172.

In very few countries does the creditor's security interest remain intact vis-à-vis the buyer, if the secured creditor agrees to the sale.

Chile: Law No. 4702 on instalment sale of movables of 1929, art. 11 para. 2 (the buyer becomes also a co-debtor of the secured claim); *Colombia*: Commercial Code of 1971, art. 1216 para. 2.

Some laws imply the ineffectiveness of the debtor's attempted disposition by spelling out expressly an aggravated consequence. The secured creditor may reclaim the encumbered goods from the buyer, occasionally within a limited period of time only.

Argentina: Ley No. 12 962 on prenda con registro of 1947, art. 41; *Belgium*: Loi sur la mise en gage du fonds de commerce of 1919, art. 11 para. 2 (reclamation within six months); *Colombia*: Commercial Code of 1971, art. 957; *Finland*: Chattel Mortgage Act of 1923, § 5 (reclamation within 30 days); *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 21; *Mexico*: Civil Code of 1928, art. 2873 para. 2; Ley General de títulos y operaciones de crédito of 1932, art. 330; *Nicaragua*: Law on agrarian and industrial pledge of 1937, arts. 20 and 27 para. 4; *Peru*: Law No. 2402 on registration of agricultural pledges of 1916, art. 10; Ley No. 6565 on instalment sales of 1929, art. 4; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, art. 9 para. 1.

The general principle is to maintain the secured creditor's security interest in spite of the debtor's disposition. There is one major exception to this rule recognized in many countries. If the buyer did not know of the existing security interest and also was not obliged to know of it, such *bona fide* acquisition extinguishes the security interest.

Belgium: Loi sur la mise en gage du fonds de commerce of 1919, art. 11 para. 2; *Denmark, Finland* and *Federal Republic of Germany*: see Devel, Danemark p. 4, Finlande p. 5 and Allemagne p. 13; for *Finland* see also Chattel Mortgage Act of 1923, § 4 par. 1; *Hungary*: Civil Code of 1959, par. 370 (2); *Japan*: see Devel, Japon p. 4; *Netherlands*: see Devel, Pays-Bas p. 5; *Paraguay*: Decreto-Ley No. 896 on prenda con registro of 1943, art. 27; *Peru*: Law No. 2402 on registration of agricultural pledges of 1916, art. 10; *Venezuela*: Ley de hipotecas mobiliarias of 1973, arts. 64 and 65 (good faith and delivery of the goods required; but secured creditor may repurchase the goods from the buyer).

In some countries, this exception is limited to acquisitions made in shops, markets, auction sales, etc.

Chile: Law No. 4702 on instalment sale of movables of 1929, art. 18; *England* and other *Commonwealth countries*, market overt: Goode and Ziegel *op. cit.*, 1972.

The buyer's good faith even in these situations is necessary in *Colombia*: Commercial Code of 1971, art. 960; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, art. 11.

It is relevant to inquire whether the buyer's good faith is affected by the widespread recourse to registration of security interests. Only a few statutory rules deal with this question. One extreme solution is quite generally to impute knowledge of the security interest from its registration and thus to exclude *bona fide* acquisition in the case of duly registered security interests.

Australia: *Queensland*: Bill of Sales and other Instruments Act of 1955, s. 8 (1); see also *Western Australia*: Bills of Sale Act, 1899-1957, s. 27; Kenya: Chattels Transfer Ordinance 1930, s. 4; for *Lebanon* see Devel, Liban p. 3; New Zealand: Chattels Transfer Act 1924, ss. 4 and 19.

A half-way approach is to take registration into account as one of several factors in determining whether the buyer ought to have known about the security interest.

Thus apparently *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, art. 10; *Switzerland*: see Devel, Suisse pp. 13-14.

It would seem that this rule prevails in most countries with registration of security interests which have not expressly provided otherwise.

In sharp contrast to these simple rules is the involved regulation in the *United States*. The Uniform Commercial Code grants protection to buyers of encumbered goods in two situations: First, a buyer who acquires encumbered goods from a person in the business of selling the specific goods takes free of the security interest, even though it is registered and even though he knows of its existence. Free acquisition is merely excluded if the buyer knows that the sale by the debtor is in

violation of the latter's agreement with the secured creditor (such knowledge will be very exceptional). Second, a buyer of encumbered consumer goods or of encumbered farm equipment (with an original purchase-price of less than $2,500) takes free of the security interest if the latter has not been registered.

In the case of purchase money security interests for these items registration is only optional, s. 9-302 (1) (*c*) and (*d*).

The buyer must not have known of the security interest and must have bought the goods for his personal or family purposes or his own farming business.

United States: Uniform Commercial Code, s. 9-307 with s. 1-201 (9).

In all other cases a secured creditor is protected by virtue of registration against *bona fide* acquisition of the encumbered goods. Of the two exceptions, only the first relating to sales from a dealer is of far-reaching importance.

2.3.5.3 *Protection against (other) secured creditors*

The term "secured creditors" must be understood in a wide sense. It does not only include holders of the same type of security interest as that of the secured creditor, but also holders of other types of security interests and quite generally any person who is entitled to preferred satisfaction from the encumbered goods (such as a creditor with a statutory privilege). Excepted from the present discussion are merely real estate mortgagees whose position will be considered separately (*infra* 2.3.5.4).

(a) *Avoidance or attenuation of conflicts.* Conflicts between secured creditors may sometimes pose difficult problems, if not of legal regulation, then certainly in fact (especially for the secured creditor whose right is subordinated to that of another secured creditor and who thus stands to lose the security for his claim against the debtor). A few legal systems, therefore, strive to avoid or at least minimize such conflicts by restricting the creation of more than one security interest in the same goods.

Restrictions of this kind are sometimes directed against the coexistence of a security interest with *earlier* security interests. Thus *Panama* declares the creation of any security interest to be absolutely void, if the encumbered goods have already been encumbered in favour of another secured creditor.

Panama: Decreto Ley no. 2 on chattel mortgages of 1955, arts. 3, 5 and 13; Law No. 22 on agricultural pledge of 1952, arts. 3 and 5 no. 9; see also *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 2, 13 no. 3; see also arts. 21 para. 2 and 22 para. 1; similarly *Venezuela*: Ley de hipotecas mobiliarias of 1973, arts. 2, 22 no. 5 and 59 no. 5.

Other countries are less rigid and merely take various special precautions. *Argentina* and *Costa Rica* require that prior encumbrances must be disclosed by the debtor in the contract relating to the new security interest.

Argentina: Ley no. 12 962 on prenda con registro of 1947, arts. 11 lett. e) and 15 lett. e); but see *infra*, *Costa Rica*: Commercial Code of 1964, art. 541 para. 1.

In *Costa Rica* the registry is obliged to search the register for pre-existing registrations.

Costa Rica: art. 541 para. 2. But it is not provided what is to happen if an earlier registration does in fact exist.

In *Argentina* the registry has to notify the holders of earlier security interests of any new registrations within 24 hours.

Argentina: art. 20.

More frequently restrictions against multiple encumbrances are directed against *subsequent* charges. Several *South American* States prohibit the creation of additional security interests in the encumbered goods.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 7; *Chile*: Law 4702 on instalment contracts of 1929, art. 10; *El Salvador*: Commercial Code of 1970, art. 1158; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 18; *Uruguay*: Ley no. 5 649 sobre prenda rural of 1918, art. 3 no. 5 para. 3; Ley no. 8 292 on prenda industrial of 1928, art. 2 no. 4.

Panama, in addition to the above-mentioned prohibition against charging goods that are already encumbered, also prohibits the creation of subsequent security interests.

Panama: Decreto-Ley no. 2 on chattel mortgages of 1955, art. 6.

In reality, the two forms of prohibitions against coexisting security interests in identical goods, the one retrospective, the other prospective, amount to one and the same principle. What changes, is the point of view; in the former rule, the prohibition is pronounced from the view-point of the later security interest; in the latter rule, the prohibition proceeds from the view-point of the earlier security interest. Underlying both rules is the same principle, i.e. to avoid creation of a second security interest in goods that are already encumbered. If this prohibition prevents, in effect, the creation of a subsequent security interest, it obviates the necessity of solving conflicts between several security interests.

This radical effect is not achieved by the less rigid rules of those countries which merely take precautionary steps in case of multiple charges.

(b) *Priorities.* All countries which do not effectively prevent the creation of several security interests in encumbered goods must solve the resulting conflict.

The general principle for determining priorities is well expressed by the time-honoured maxim *prior tempore, potior iure*. Priority is determined by the order in time of the creation of security interests. This principle is expressly confirmed by many statutory rules.

Australia: *Queensland*: Bills of Sale and other Instruments Act of 1955, ss. 8 and 32 (2); *Western Australia*: Bills of Sale Act, 1899-1957, ss. 34 and 41; *Brazil*: Law no. 492 on rural pledges of 1937, art. 4 § 1; *Colombia*: Commercial Code of 1971, art. 1211; *Costa Rica*: Commercial Code of 1964, art. 581; *Czechoslovakia*: International Trade Code of 1964, s. 176; *Ecuador*: Commercial Code of 1959, art. 595; *Guatemala*: Civil Code of 1963, art. 908 last phrase, *Israel*: Pledges Law, 1967, s. 6; *Japan*: Construction Machinery Hypothecation Law of 1954, art. 14; *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 56 and 85 no. 4; *Sweden*: Law on enterprise mortgage of 1966, §§ 19-22; *United States*: Uniform Commercial Code, s. 9-312 (5); *Venezuela*: Ley de hipoteca mobiliaria of 1973, art. 71 no. 4.

It would seem that the principle prevails also in all other countries, even if express statutory authority is lacking.

But the principle of determining priority between conflicting security interests by reference to the time of their creation does not apply without exception. Some countries have granted priority to certain claims which appear to deserve preferential treatment for a variety of reasons. An exhaustive catalogue of such preferences cannot be offered here. However, a choice of some typical preferred claims may be instructive.

In the *German Democratic Republic* a possessory security interest prevails over a non-possessory security interest which is not a purchase money security interest.

German Democratic Republic: Gesetz über internationale Wirtschaftsverträge of 1976, art. 238(1).

A typical conflict arises in the case of the *landlord's lien* where the encumbered goods are on premises rented by the debtor. Many countries, especially in *South America*, accord a preference to the landlord's claim for outstanding rent, at the same time limiting the amount of the preference.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 42 (two months of rent for urban and 12 months for rural immovables); *Australia*: *Victoria*: Instruments Act 1958, s. 63 (rent for one year); *Chile*: Law no. 5687 on the contract of prenda industrial of 1935, arts. 26 and 45; Law no. 4702 on instalment sale of movables of 1929, art. 9; *Costa Rica*: Commercial Code of 1964, arts. 535 and 573 lett. d); *Nicaragua*: Commercial Code art. 34 para. 1 lett.

b); *Panama*: Law no. 22 on agricultural pledge of 1952, art. 2 para. 2; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, arts. 7-9, 32 and 33 no. 3; *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, arts. 6 and 13 para. 1 no. 2; *Spain*: Ley de hipoteca mobiliaria of 1954, art. 66 no. 2; *Uruguay*: Ley no. 5649 sobre prenda rural of 1918, art. 8.

The attitude of the *European* countries in the case of a reservation of ownership seems to be divided. Some would not grant the preference for the landlord's lien in cases of reservation of ownership.

Expressly *Venezuela*: Decreto no. 491 on sales under reservation of ownership of 1958, art. 16. See also *Germany*: court practice.

In other countries the landlord's lien prevails either absolutely

Egypt: see Devel, Egypte p. 3

or at least if the landlord does not know and is not obliged to know of the secured creditor's reservation of ownership.

Switzerland: see Devel, Suisse p. 14.

Socialist countries often confer priority upon security interests securing credits of State-banks.

USSR: Code of Civil Procedure of the RSFSR of 1964, s. 424.

A few statutes expressly confer priority upon certain *fiscal claims*.

Australia: *Western Australia*: Bills of Sale Act, 1899-1957, s. 28; *England*: Bills of Sale Act (1878) Amendment Act, 1882, s. 14; Companies Act, 1948, ss. 94 and 319; *France*: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 9 para. 1 no. 1, but see para. 2.

This is probably only a rather incomplete catalogue of fiscal privileges existing in the various countries which claim priority over security interests.

A similar preference is granted by some countries to *claims of labourers* and related "social" claims.

England: Companies Act, 1948, ss. 94 and 319; *France*: Loi relative au nantissement d'outillage et du matériel d'équipement of 1951, art. 9 para. 1 no. 3, but see para. 2; *Spain*: Ley de hipoteca mobiliaria of 1954, art. 10 para. 1; *USSR*: Code of Civil Procedure of the RSFSR of 1964, ss. 419 and 424.

Apart from these preferential rights established to secure certain economic or social interests, there are certain priorities to be found which are created in favour of specific classes of secured creditors.

The most interesting of these is the priority of purchase money security interests (see *supra* 2.3.2.2) in the *United States*. The Uniform Commercial Code s. 9-312 distinguishes between two situations: A purchase money security interest in "inventory"

i.e., goods held for sale or lease, raw materials, work in process, or materials used or consumed in a business, Uniform Commercial Code s. 9-109 (4)

and in other goods. A purchase money security interest in the latter "general" goods has priority, provided only that the interest is "perfected" (i.e., as a rule, filed) at the time the debtor receives possession or within 10 days thereafter.

United States: Uniform Commercial Code s. 9-312 (4). A purchase money security interest in inventory requires: (1) perfection of the interest at the time the debtor receives possession and (2) prior notification of any other holder of a security interest in the encumbered goods showing that the purchase money creditor has acquired or expects to acquire a purchase money security interest in specified inventory.

Uniform Commercial Code s. 9-312 (3).

The official comment states (no. 3) that the preference for purchase money security interests is an American tradition. The distinction between the two situations is justified by the observation that only inventory financers usually pay by periodic advances, so that the notification can warn them against further payments.

The technique of notification is also used in *France* to obtain a preference.

France: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 9 para. 2 and 3 (copy of security agreement to be notified to holder of security interest in business enterprise).

Guatemala requires notification to a prior secured creditor in order to offer him the chance of granting the credit which the new creditor has promised to the debtor. If, however, the first secured creditor refuses to grant this credit, his priority as against the second secured creditor is not affected.

Guatemala: Civil Code of 1963, art. 908.

Some countries require not only notification, but *consent* of the prior secured creditor. But only in one case does such consent clearly imply that the agreeing secured creditor is subordinated to the rights of the new secured creditor.

Brazil: Decreto-Lei no. 1271 on pledges of industrial machines of 1939, art. 2 § 2 and Decreto-Lei no. 4 191 on pledges of industrial machines which have been installed in immovables of third persons of 1942, art. 1.

In other instances the consent of the prior secured creditor is necessary, but apparently only in order to protect his interests and without adverse effects on his security interest.

Brazil: Law no. 492 on rural pledges of 1937, art. 9 (rural pledge of tenant requires owner's consent); *Nicaragua*: Law on agrarian and industrial pledge of 1937, arts. 6 lett. f) and 21 para. 1 (consent of prior secured creditor); *Uruguay*: Ley no. 5649 sobre prenda rural of 1918, art. 13.

2.3.5.4 *Protection against real estate mortgagees*

Conflicts between creditors with a security interest in movable goods and the holders of real estate mortgages are of a special character and therefore deserve separate discussion. Conflicts between these two groups of secured creditors are apt to be brought about by movable goods which become affixed to immovables and thus may pass from one class of goods to another (fixtures, *"immeubles par destination"*). The most frequent example is machinery which is more or less permanently fixed to a building.

A precise delimitation of this group of goods cannot be offered here. We must accept for the purposes of our inquiry that most legal systems treat certain goods which in some specific manner have become affixed to immovables as immovable property. Precisely under which conditions this occurs, is determined by the applicable property law.

We shall deal here only with the effects which follow if certain goods have obtained the status of fixtures.

It seems useful to distinguish clearly between two situations. First, encumbered movable goods become affixed to realty. What consequences follow for the rights of the holder of the security interest on the one hand and of (a) real estate mortgage(s) on the other? Second, under what conditions can fixtures that are subject to (a) real estate mortgage(s) be encumbered with a security interest in movables?

(a) *Encumbered movables become fixtures.* In most countries a security interest in movables is preserved and retains priority as against existing real estate mortgages.

Australia as to goods under hire-purchase: state of *Queensland*: Hire-purchase Act 1959, s. 32 (1); *Victoria*: Hire-Purchase Act 1959, s. 27 (1); *Belgium*: Cour de Cassation 26 May 1972, *Pasicrisie* 1972.1.889; *Canada*: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 15 (upon registration in the land register); *Chile*: Law no. 4702 on instalment sale of movables of 1929, art. 8; *El Salvador*: see Commercial Code of 1970, art. 1144, para. 2; *France*: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 8; *Federal Republic of Germany*: see Devel, Allemagne, p. 19; *Italy*: see Civil Code art. 819; Law no. 1329 providing for the acquisition

of new machines of 1965, art. 5; *Japan*: see Devel, Japon pp. 5-6; *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 6; *Netherlands*: see Devel, Pays-Bas, pp. 8-9; *New Zealand*: Chattels Transfer Act 1924, s. 57 (7) for customary, i.e. unregistered, hire-purchase agreements; *Norway*: see Devel, Norvège, pp. 5-6 (upon registration in the land-register); *Panama*: Decreto Ley no. 2 on chattel mortgages of 1955, arts. 4 and 5; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 6 para. 1 sent. 2; *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, art. 20 para. 1; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 75 paras. 1 and 2 (upon registration in the land-register); *Sweden*: Immovables Law of 1970, chap. 2 § 4 para. 1 (for machines); *Switzerland*: see Mertens p. 205; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 52 (but see *infra* the special rule for industrial machinery).

Only few countries adhere to the opposite view that the security interest in movables is extinguished by affixing the movables to realty.

Denmark: Tingslysningslov of 1926, § 38, and see Devel, Danemark p. 6; *England* and *Commonwealth* countries under the common law: Goode and Ziegel 173-174; *Venezuela*: Decreto no. 491 on sales under reservation of ownership of 1958, art. 3.

Finland avoids the problem for chattel mortgages by providing that these do not comprise fixtures.

Finland: Chattel Mortgage Act of 1923, § 3 para. 1.

The reverse rule is adopted in Venezuela where real estate mortgages do not comprise industrial machinery subject to one form of chattel mortgage, unless the contrary is provided.

Venezuela: Ley de hipotecas mobiliarias of 1973, art. 42 para 2.

Special rules have been developed in some other countries. The *United States* follow, under present law, the general rule stated above, at least in general.

United States: Uniform Commercial Code s. 9-313 (2). An exception only occurs if a real estate mortgagee advances money after the movables have become fixtures without knowing of this security interest and before it is perfected, s. 9-313 (4).

However, this rule has not satisfied real estate creditors and will be amended in the revision of the Code that is presently under way. Under the proposed new version of s. 9-313, the present general rule will be considerably restricted. As against existing real estate mortgagees, a security interest in movables will only prevail: first, if it secures purchase money (*supra* 2.3.2.2) and is filed in the office where real estate mortgages are filed; or, second, if the movables are easily removable machines or replacements of domestic appliances.

Final Report of Proposals for Changes in art. 9 Uniform Commercial Code, April 1971, s. 9-313 (4) (a) and (c).

In *Austria* a special provision has been enacted relating to the most important species of fixtures, i.e., machinery. The secured creditor is permitted, with the consent of the landowner, to enter an annotation of his security interest in the land register which then prevails against real estate mortgagees.

Austria: Civil Code § 297 a.

However, in practice little use has been made of this possibility and the provision itself is widely regarded as obnoxious and in need of repeal.

(b) *Can fixtures be encumbered like movables?* If movables that have become fixtures are encumbered by a real estate mortgage, the latter has, in general, preference against any security interest subsequently created in these fixtures. It follows that the creation of such a security interest requires the consent of the real estate mortgagee(s), if priority is to be achieved. The one or the other of these two supplementary rules is recognized in most countries.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 10, sent. 2; *Belgium*: Cour de Cassation 26 May 1972, Pasicrisie 1972.1.889; *Brazil*: Law no. 492 on rural pledges of 1937, art. 4 para. 1; *Colombia*: Commercial Code of 1971, art. 1214; *Denmark*: Tingslysningslov of 1926, § 38; *Ecuador*: Commercial Code of 1959, art. 580; *Nicaragua*: Law on agrarian and industrial pledge of 1937 (arts. 4 and 6 lett. f); *Panama*: Decreto Ley no. 2 on chattel mortgages of 1955, art. 4; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 6 para. 1; *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, art. 20 para. 2; *Uruguay*: Ley no. 5649 on prenda rural of 1918, art. 5; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 51, second paragraph.

The two basic rules for goods that become fixtures and for those that are fixtures, can be reduced to one general principle: *prior tempore, potior jure*. It is the same basic rule that underlies the solution of most conflicts relating to priority. This general rule is found in at least two countries.

Egypt: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 16 para. 2; *Lebanon*: Décret-Législatif no. 11 (on the sale and mortgaging of an enterprise) of 1967, art. 25 para. 2.

However, a few countries dissent and prefer the creditor of a subsequent security interest. *El Salvador* regards fixtures, after they have been charged with a security interest in movables, as separate from the immovable to which they are affixed; this would seem to imply priority of the newly created security interest.

El Salvador: Commercial Code of 1970, art. 1144 para. 2.

France achieves a similar result, but on condition that the subsequent security interest be notified to the real estate mortgagee.

France: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 9.

This latter idea has been enlarged in two *South American* countries. These also require notification of the real estate mortgagee who has thereupon the option to grant the credit offered by the second creditor; if he refuses to make this offer, the security interest for the new creditor has priority over the real estate mortgage.

Guatemala: Civil Code of 1963, art. 905; see also *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 42 (limited to certain credits for the promotion of new agricultural or industrial ventures).

2.3.5.5 *Conclusions*

Our conclusions on the secured creditor's protection against third persons must perforce follow the categorization of the various problems laid down in the preceding sections.

(a) *Protection against unsecured creditors* may be positive or negative. We can dispose quickly of the latter. Where security interests are denied any protection in bankruptcy, their character as a security interest is in effect negated. In other words, some positive protection in the debtor's bankruptcy is a necessary prerequisite of a security interest.

Security interests are protected both in the case of execution against, and in the bankruptcy of, the debtor in two forms, with an intermediate third form in bankruptcy: first, immunity from seizure of the encumbered goods; this implies, in the case of bankruptcy, the secured creditor's right to reclaim the goods from the debtor's estate. Or second, liability to seizure and forced sale of the encumbered goods, but priority in the proceeds of the sale. Or third, in the case of bankruptcy of a debtor who had purchased the encumbered goods under a reservation of ownership, liability to seizure of the goods, but against full payment of the balance of the purchase-price by the debtor's estate. Alternatives (1) and (3) are at the option of the debtor's trustee in bankruptcy.

Looking at the practical results, alternatives (1) and (3) are almost equal in their effect, with (3) being slightly more effective because it provides the secured creditor with the money bargained for rather than the encumbered goods. However, al-

ternative (3) is limited to purchase money security interests, where the debtor has agreed to acquire the encumbered goods. Alternative (2) is liable to provide the weakest protection, if the proceeds from the forced sale of the encumbered goods do not fully cover the secured claim. This is a real risk since prices on forced sales are usually rather low; however, the creditor can in part protect himself by fixing a sufficient margin when demanding security.

The choice between alternatives (1) and (2) should—contrary to present rules—certainly not depend upon the legal form in which the security interest is cast. This external factor cannot be relevant to the issue.

Neither of the two alternatives is fully convincing. The drawback of alternative (1) is that the secured creditor retains in executions the full value of the encumbered goods and, in bankruptcy, even obtains them physically, although the debtor is either their owner or at least has an expectancy in acquiring ownership in them. Thus the debtor or his other creditors are put at a disadvantage. On the other hand, a forced sale of the encumbered goods in alternative (2) is uneconomical and is therefore liable to violate the interests of both creditor and debtor.

The dilemma should be solved by developing an intermediate solution. The secured creditor ought to choose between alternative (2) and an amended form of alternative (1): the creditor may only claim the encumbered goods against payment of their fair value which has to be fixed by an objective valuer. The creditor's payment, of course, may be set off against the debtor's secured debt, either party being obliged to pay out any remaining surplus. This amended version of alternative (1) will often lead to the same result as may follow from the liquidation of the underlying contractual relationship between secured creditor and debtor. But it would seem to be preferable to achieve this result on the level of the security interest rather than to derive it from the vagaries of the contractual relationship between the parties.

(b) *Protection against purchasers* is attempted at several levels. The most direct method is to prohibit the debtor from disposing of the encumbered goods, unless he is a merchant or the sale provides the means for repaying the secured loan and is in fact used for this purpose.

However, the secured creditor really requires protection only on the next level, i.e. against unauthorized dispositions by the debtor which are not combined with repayment of the loan. Such an unauthorized disposition is generally held to be ineffective vis-à-vis the secured creditor. The only major exception is made in favour of a *bona fide* purchaser, i.e. a purchaser who did not know of the existing security interest and ought not to have known of it. The principle and the exception correspond to the general rules of the various countries relating to the treatment of *bona fide* acquisitions. It will not be desirable to disturb these general rules, unless there are compelling reasons to depart from them for security interests.

The only feature peculiar to security interests arises from the widely used systems of registering them. Does registration affect the good faith of purchasers? It would seem that no general reply, affirmative or negative, is appropriate. Probably one should start from the proposition that registration, in general, destroys good faith because this is precisely its main function. However, an exception is to be made where the debtor is explicitly or impliedly empowered to sell, especially if he trades in the encumbered goods.

In this sense also Goode and Ziegel *op. cit.*, 171.

(c) *Protection against (other) secured creditors.* Understandably some countries attempt to avoid conflicts between several secured creditors by declaring second charges on goods already encumbered to be void. It would seem that such a prohibition of double charging can effectively only be realized under a system of registration. But even if this condition is fulfilled, the question must be asked whether this simplistic solution is economically feasible and desirable. This may be true for countries with a relatively restricted credit system or, more specifically, where credit is usually supplied by a single source. It would seem that neither of these two factors is present in the more industrialized countries. In the latter, in fact, there is a sound practice of multiple financing of an enterprise which calls for securing the credits; but since the items to be charged are limited, multiple security interests in individual items are often unavoidable, if not necessary. Therefore a modern security system cannot prohibit multiple charges, but has to face them.

Conflicts between several security interests are, as a rule, solved by the universally recognized principle *prior tempore, potior iure.* Priority is determined by the sequence in time in which the security interests have been created.

However, many countries prefer certain claims by excepting them from the time-priority-rule. No uniform pattern can be established for these exceptions which are based upon various economic or social considerations. Typical examples are the preferences conferred upon the landlord's claim for rent, fiscal claims and wage claims, including related "social" claims. However, whether and if so, which of these privileged claims has priority to a security interest, differs from country to country. In the absence of universal trends it would hardly be realistic to submit recommendations as to possible uniform rules in this particular area.

Matters are different as regards preferences granted to specific classes of secured creditors. The most prominent example is the priority enjoyed by purchase money security interests in the United States. This is just one expression of the widespread idea that purchase-money-creditors deserve better treatment than mere money-creditors. However, it may be doubted whether any such inborn preference for one class of secured creditors over another is still justified. It would seem that all classes of secured creditors should be treated alike. Therefore the American model does not appear to be recommendable.

Better balanced is the rule which grants priority to a subsequent creditor only upon notification of the preceding secured creditor. This solution also is prejudiced in favor of the second creditor; but the first creditor is at least given a chance to defend his prior rights.

(d) *Protection against real estate mortgages.* In most countries a security in chattels that are firmly affixed to realty and therefore become fixtures, will be preserved as against the competing claims of existing real estate mortgagees. The reverse rule is also generally recognized: real estate mortgages that have been created after movable goods have been affixed to the realty, take priority over security interests subsequently created in the fixtures.

Both rules can be reduced to the general principle *prior tempore, potior iure.*

Similarly Goode and Ziegel *op. cit.*, 174, who demand, however, registration in the land-register as a condition for protection against holders of real estate mortgages created after the affixing of the encumbered items (p. 175).

2.3.6 *Enforcement*

The stage at which a security interest must prove its final value arrives when the debtor, after the secured claim has become due, is unable or unwilling to make payment. Then the creditor must enforce his security interest. The effectiveness of the latter depends in no small measure on the effectiveness, speed and low cost of the enforcement procedure. In this area, which borders on procedure, the various national legal systems again show a broad spectrum of variations. As regards certain special rules for enterprise mortgages see *supra* 2.3.4.3.

(a) *Forfeiture clause.* Any clause in the security agreement in effect providing that after the secured claim has fallen due, full title to the encumbered goods is to vest in the secured creditor, is generally prohibited.

Argentina: Ley no. 12962 on prenda con registro of 1947, art. 36; *Belgium*: Loi sur la mise en gage du fonds de commerce of 1919, art. 12, in conjunction with Commercial Code, title VI art. 10; *Brazil*: Law no. 4728 of 1965 as

amended, art. 66 § 6; *Colombia*: Commercial Code of 1971, art. 1203; *Costa Rica*: Commercial Code of 1964, art. 536; *Guatemala*: Civil Code of 1963, art. 882 para. 2; *Mexico*: Civil Code art. 2887; *Panama*: Ley no. 22 sobre prenda agraria of 1952, art. 21; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 31.

One country emphasizes that a forfeiture clause is objectionable only if contained in the original security agreement. An agreement transferring title to the encumbered goods upon the creditor, if made after the secured claim has fallen due, is valid.

Mexico: Civil Code art. 2883; Ley general de titulos y operaciones de credito of 1932, art. 344.

(b) *Private v. public enforcement.* The most important distinction between the various general approaches to enforcement centres round the question whether enforcement should be left to the secured creditor or whether public authorities should be involved in it.

The intervention of public authorities is intended to guard against the risk that the secured creditor, in enforcing his security interest, will primarily look to his own interests which coincide only in part with those of the debtor. The creditor is only interested in recovering from the proceeds an amount equivalent to his claim and expenses, whereas the debtor is anxious to realize as much as possible, since he will be entitled to any surplus over the secured creditor's claim.

On the other hand, the intervention of public authorities in the enforcement procedure inevitably involves delays and additional expenses and is thus less welcome to both the secured creditor and the debtor.

It remains to be seen how the various legal systems strike a balance between these conflicting principles during the successive phases of enforcement. If a particular legal system provides for several alternative methods of enforcement, as happens sometimes, we shall merely mention the most liberal one, i.e. that in which the creditor's position is the strongest.

(c) *Preservation of the encumbered goods.* In non-possessory security interests the encumbered goods are in the custody of the non-paying debtor. The first objective of the secured creditor is, therefore, to obtain possession of the goods or, at least, to withdraw them from the debtor's possession.

Under the "private enforcement" approach, the secured creditor himself is entitled to take possession of the encumbered goods, without judicial intervention.

Belgium: Loi sur la mise en gage du fonds de commerce of 1919, art. 11 para. 1; *Canada*: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 13 (1); *United States*: Uniform Commercial Code s. 9-503.

However, such self-help is only permitted if it can be carried out "without breach of the peace"; otherwise a judicial action must be instituted.

Expressly *United States*, s. 9-503.

This leads to a second group of countries which always require an action to be filed before the goods can be removed, unless the debtor voluntarily surrenders the encumbered goods. Thus self-help is excluded.

Costa Rica: Commercial Code of 1964, art. 567; *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 10; *Panama*: Decreto Ley no. 2 on chattel mortgages of 1955, arts. 27 and 29 (provided the debtor has paid less than half of the secured debt); Ley no. 22 on agricultural pledge of 1952, art. 17; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 84 rule 3; *Venezuela*: Decreto no. 491 on sales under reservation of ownership of 1958, art. 22 (judicial discretion); Ley de hipotecas mobiliarias of 1973, art. 69 rule 2 para. 2.

In a third group of countries the court, on the application of the secured creditor, orders the debtor to deposit the encumbered goods with a third person, but not with the creditor himself.

Brazil: Law no. 492 on rural pledges of 1937, art. 23 para. 1 and § 3; *Chile*: Law no. 4702 on instalment sale of movables of 1929, art. 20; *Ecuador*: Commercial Code of 1959, art. 596 paras. 2 and 3; *Uruguay*: Ley no. 12 367 of 1957, art. 26 para. 2.

To a similar effect probably *Argentina*: Ley no. 12 962 on prenda con registro of 1947, art. 29, and *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 28 para. 2.

(d) *Judicial intervention before disposition of the encumbered goods.* Under the "public approach" to enforcement, usually some judicial intervention takes place before the encumbered goods can be disposed of for the creditor's benefit. However, the forms of such intervention vary considerably.

The classical, although most cumbersome form is the bringing of an action against the debtor by the secured creditor in order to obtain a judgement entitling him to enforcement. It must be assumed that this rule prevails wherever no special forms of judicial intervention have been devised.

One variation consists in modifying normal judicial procedure with a view to speeding up final determination of the litigation. This object is achieved, first, by limiting the objections which the debtor may raise.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 30; *Brazil*: Decreto-Lei no. 911 of 1969, art. 3 § 2; *Chile*: Law no. 5687 on the contract of "prenda industrial" of 1935, art. 44; *Costa Rica*: Commercial Code of 1964, art. 565 (payment is the only objection admitted); *Panama*: Ley no. 22 on agricultural pledge of 1952, art. 19; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 25 (only payment).

In addition, a few countries limit the time within which objections may be raised, to three days!

Brazil: Decreto-Lei no. 911 of 1969, art. 3 § 1; *Mexico*: Ley general de títulos y operaciones de crédito of 1932, art. 341 para. 2.

In another group of countries, the creditor must apply to the court for a decree authorizing the sale of the encumbered goods. This amounts in effect to a summary non-contentious procedure instead of a litigated action.

Ecuador: Commercial Code of 1959, art. 596; *Finland*: Chattel Mortgage Act of 1923, § 14; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 16; *Israel*: Pledges Law, 1967, s. 17 (except in the case of banks); *Mexico*: Civil Code art. 2881; Ley general de títulos y operaciones de crédito of 1932, art. 341; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 84 rule 2; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 70 rule 2.

In two countries, the judicial order of public sale is preceded by an order for payment emanating from the court and directed to the debtor.

Nicaragua: Law on agrarian and industrial pledge of 1937, art. 28 para. 2; *Peru*: Ley no. 6565 on instalment sales of 1929, art. 6.

Still more liberal are those countries which do not require the creditor to obtain any judicial permission for his disposition of the goods. He derives his power from the law in general.

This is the position, e.g., in the *United States* and in *Germany*.

(e) *Sale.* Disposition of the encumbered goods must be made in most countries by way of *public* sale.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 31; *Ecuador*: Commercial Code of 1959, art. 596 para. 1; *Finland*: Chattel Mortgage Act of 1923, § 14; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 17; Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 14 para. 1; *Mexico*: Civil Code art. 2881; *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 28 para. 2 lett. b); *Panama*: Decreto-Ley no. 2 on chattel mortgages of 1955, art. 34 (provided the debtor has paid more than half of the debt secured); Ley no. 22 on agricultural pledge of 1952, art.

19; *Peru*: Law no. 6565 on instalment sales of 1929, art. 6; *Philippines*: Chattel Mortgage Act of 1906, s. 14 (1); *Spain*: Ley de hipoteca mobiliaria of 1954, art. 84 rule 4; *Uruguay*: Ley no. 12 367 of 1957, art. 26 para. 2; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 70 rule 4.

Certain countries permit disposition by *private* sale.

Australia: states of *New South Wales*: Bills of Sale Act, 1898-1938, s. 4 C (1); and *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 45 and Fifth Schedule no. (4); *Brazil*: Law no. 4728 of 1965, as amended, art. 66 § 4, and Decreto-Lei no. 911 of 1969, art. 2; *Czechoslovakia*: International Trade Code of 1964, s. 174 (express agreement necessary unless the encumbered goods are in the possession of the creditor); *Federal Republic of Germany*: See Devel, Allemagne p. 25; *Mexico*: Civil Code art. 2884 (express agreement necessary); Ley general de títulos y operaciones de credito of 1932, art. 341 para. 3 (commercial pledge); *United States*: Uniform Commercial Code s. 9-504 (3).

In cases of reservation of ownership the seller's rescission of the contract of sale will entitle him to reclaim the goods and keep or dispose of them in any manner whatsoever. One country, however, requires sale of the repossessed goods by the seller himself. The sale may be private if the seller does not insist on reimbursement by the debtor of any shortfall between the amount secured and the proceeds of sale; if the seller wishes to preserve this claim, he must proceed by way of public sale.

Canada: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 13 (2) and (3).

Apparently everywhere the debtor must be given prior notification of the sale of the encumbered goods. He is usually granted some time before disposition of the goods in order to give him a last opportunity to redeem the goods for himself by making payment to the creditor. The "grace period" varies between five days in Chile and Spain to 20 days in Canada and Panama.

A few countries also provide for notification of later-ranking secured creditors. In effect, such a rule appears to be limited to countries with a registration system, although, on the other hand, only very few of these have established this requirement.

Many countries prescribe notification in the case of disposal of a mortgaged enterprise:

France: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 17 para. 1; see also, following this model, *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 14 para. 3; *Lebanon*: Décret législatif no. 11 (on sale and mortgaging of an enterprise) of 1967, arts. 30 para. 2 and 32; *Tunisia*: Commercial Code of 1959, art. 245 para. 1.

Very few countries prescribe this notification in other cases: *France*: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 10; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 84 rule 2 para. 3; *United States*: Uniform Commercial Code s. 9-504 (3).

The purpose of notifying subordinated secured creditors is to give them an opportunity to preserve the encumbered goods in the hands of the debtor. They may, by paying off the first-ranking secured creditor, save the encumbered goods as security for their own outstanding claims.

(f) *Conclusions.* The value of any security interest is put to a final test when its enforcement becomes necessary. Justice, efficiency, speed and low cost are the criteria for an effective enforcement procedure.

(1) A *forfeiture clause* in the security agreement is generally prohibited and void. But the prohibition does not cover an agreement between debtor and creditor concluded after the former has fallen in default and by which he transfers title to the encumbered goods upon the creditor.

(2) *Reclamation of the encumbered goods* from the debtor is in some countries left to the creditor's self-help, provided this is peaceful. Most countries require a judicial action by the creditor, while others provide for a judicial decree ordering the debtor to deposit the encumbered goods with a third person.

It would seem that these three basic solutions do not exclude each other. Peaceful self-help, i.e. removal without objection by the debtor, is the most efficient, swift and cheap method of preserving the encumbered goods. Abuses by the creditor should be sanctioned by providing damages and possibly a fine for unjustified removal. Judicial intervention becomes necessary where the debtor resists removal by the creditor. A special speedy proceeding for sequestration of the encumbered goods is important if continued use of dispositions by the debtor is likely.

(3) *Steps preceding disposition of the goods.* Wherever no special forms of judicial intervention have been devised, the creditor will usually have to bring an action against the debtor; the resulting judgement entitles the creditor to enforcement. Some countries facilitate this procedure by limiting the debtor's grounds of objection and/or the time for bringing them. Even speedier is a summary non-contentious proceeding resulting in a decree which authorizes the creditor to sell the encumbered goods. The simplest method is to dispense with any judicial intervention, the creditor's permission to dispose of the encumbered goods being contained in the law itself.

Upon a comparative evaluation of the various approaches, the last-mentioned liberal solution seems to be optimal. It is speedy and saves costs. The debtor's interest in obtaining a fair determination of the parties' mutual rights can be sufficiently protected by obliging the creditor to pay damages for an unjustified disposition of the encumbered goods.

(4) *Disposition of the goods.* Disposition is dominated again by the dichotomy between public and private, here of the sale. The only criterion ought to be the practical one, which of the two methods achieves the better results. Perhaps the answer must vary from country to country. It is a fact that in some countries public sales are attended by only few people and that consequently prices are notoriously low. Here public sales are not practicable. The necessary initiative of the creditor to achieve a good price on a private sale must be sanctioned by an obligation to pay damages for any unreasonable disposition.

Disposition by the creditor will be the rule, but should not be obligatory. If the creditor wants to retain the encumbered goods, but cannot agree with the debtor upon a price, the latter should be fixed by a court-appointed expert.

The creditor must notify both the debtor and, if he knows of them, subordinate secured creditors of the proposed sale.

The above rules should be extended to cover also reservations of ownership. Their security purpose prevails over their legal form of ownership. The "reserved owner" is as much a secured creditor as any other. Moreover, the liberal and flexible rules proposed here accommodate sufficiently the interests of the "reserved owner".

2.4 *Statutory non-possessory security interests in favour of the seller*

2.4.1 *Purpose*

The chief purpose of the seller's statutory interests is obviously to secure payment from the buyer of the purchase-price. The interest will only come into operation if a seller is not paid before or contemporaneously with delivery of the goods sold. Since it is a statutory right, no contractual agreement or other formality is, as a rule, required for the creation of the statutory interests.

Wherever the legislator has created a protection of this nature in favour of sellers, the assumption obviously is that the voluntary extension of trade credit by sellers is a frequent and desirable phenomenon and that the credit-extending seller deserves special protection. This protection is particularly important in those countries which are, or at least were, reluctant to make contractual security interests available to sellers, such as France and many other Latin countries. The existence of a seller's statutory protection appears to be less called for in

countries where sellers can easily create contractual security interests, especially by reservation of ownership.

Quite different considerations must underlie the protection of a second class of sellers, namely those who have contracted the sale on a cash basis, but have nevertheless not been paid. Again this type of seller is often regarded as deserving protection — sometimes even more so than the credit-seller. This is obviously based upon the assumption that the legislator must take steps to protect the unpaid seller against the risk of the buyer's insolvency.

2.4.2 *Two situations of seller's protection*

Even a cursory survey of the various rules on the seller's protection reveals that most of the provisions clearly envisage two different situations. One set of rules seeks to protect the unpaid seller during transit of the goods from the seller to the buyer. The other seeks to protect the unpaid seller subsequent to delivery of the goods to the buyer.

These two differing sets of rules correspond to two successive stages in the performance of the seller's duty to deliver the goods sold. The factual situation during transit, before the goods have reached the buyer, differs considerably, as is obvious, from that after receipt of the goods by the buyer.

2.4.3 *Stoppage* in transitu

Very many countries entitle the seller to prevent delivery of the goods while these are in the course of transit to the buyer. This right is derived variously: from a right of stoppage *in transitu* properly so-called, from the seller's ownership in the goods sold or from some other source. All these rules, however designated, are analysed here under the functional criterion of how effectively they enable the unpaid seller to regain possession of the dispatched goods.

2.4.3.1 *Conditions*

The two main factors upon which the seller's right of stoppage *in transitu* depends, are the location of the goods sold and the buyer's financial position.

(*a*) Stoppage of the goods in transit presupposes that the goods have been dispatched by the seller, but have not yet reached the buyer (or his agent). This is required almost everywhere.

Argentina: Ley de concursos no. 19 551 of 1972, art. 143 no. 1; *Austria*: Konkursordnung of 1914, § 45; *Chile*: Ley de quiebras of 1931, art. 92; *England*: Sale of Goods Act, 1893, s. 45; *France*: Loi no. 67-563 of 1967, art. 62 para. 1; *Federal Republic of Germany*: Konkursordnung of 1877, § 44 para. 1; *Hungary*: Civil Code of 1959, para. 281; *Italy*: Decreto sul fallimento of 1942, art. 75; *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *Scandinavia*: (Uniform) Sales Law of 1905/1907, § 39; *Spain*: Commercial Code art. 909 para. 1 no. 9; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1; *United States*: Uniform Commercial Code, s. 2-705 (2) (a).

For international commercial transactions it is important to know whether delivery to the buyer of a negotiable document of title, especially a bill of lading, affects the seller's position. In general it does not have an adverse effect.

Czechoslovakia: Law on International Trade of 1963, § 364 para. 1; *England*: Sale of Goods Act, 1893, s. 47 (2); *German Democratic Republic*: Gesetz über internationale Wirtschaftsverträge, art, 231 (1); *Scandinavia*: (Uniform) Maritime Law of 1891/1893, art. 166 para. 1; *Spain*: Commercial Code art. 909 para. 1 no. 9.

This rule has also been adopted by the (Hague) Uniform Sales Law of 1964, art. 73 para. 2.

In the *Federal Republic of Germany* and the *United States* the position is somewhat different. In the former country, the courts require presentation by the seller of all the copies of the negotiable document of title. In the United States negotiation to the buyer of a negotiable document of title to the goods terminates the seller's right of stoppage as against the buyer.

United States: Uniform Commercial Code, s. 2-705 (2) (d).

Correspondingly, a carrier or other bailee of the goods need not obey the seller's stop order until surrender of the document.

S. 2-705 (3) (*c*).

The effect of negotiation of documents to a third person is considered later (*infra* 2.4.3.3 sub (*b*)).

(*b*) The *buyer's financial position* on which may depend the unpaid seller's right of stoppage is defined in different ways.

The narrowest criterion, and one employed mainly by continental European and Latin American countries, is the buyer's bankruptcy.

Argentina: Ley de concursos no. 19 551 of 1972, art. 143; *Austria*: Konkursordnung of 1914, § 45; *Chile*: Ley de quiebras no. 1 297 of 1931, art. 90 para. 1; *France*: Loi no. 67-563 of 1967, art. 62 para. 1; *Federal Republic of Germany*: Konkursordnung of 1877, § 44 para. 1; *Italy*: Decreto sul fallimento of 1942, art. 75; *Netherlands*: Commercial Code art. 232 para. 1; *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *Spain*: Commercial Code art. 909 para. 1 no. 9; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1.

In England, the Scandinavian countries and the United States insolvency of the buyer suffices.

England: Sale of Goods Act, 1893, ss. 44, 62 (3); *Scandinavia*: (Uniform) Sales Law of 1905/1907 § 39; *United States*: Uniform Commercial Code ss. 2-705 (1), 1-201 (23) (however, mere delay in payment is held sufficient where a carload, truckload, planeload or larger shipment of express or freight has been promised, s. 2-707 (1)).

Even more liberal are the (Hague) Uniform Sales Law of 1964 and Czechoslovakia. Here it suffices if the economic situation of the buyer appears to have deteriorated to a point where there is good reason to fear non-payment of the purchase-price.

See (Hague) Uniform Sales Law of 1964, art. 73 para. 2; *Czechoslovakia*: Law on International Trade of 1963, §§ 364 para. 1, 363 para. 1.

Dutch law has a very exceptional provision under which the seller is deprived of the right of stoppage even where the buyer has become bankrupt if the seller has drawn a bill of exchange for the purchase-price on the buyer who has accepted the same for payment. Apparently the bill here is regarded as sufficient security.

Netherlands: Commercial Code art. 236.

2.4.3.2 *Consequence*

The right of stoppage entitles the seller to prevent delivery and to reclaim possession of the goods.

Argentina: Ley de concursos no. 19 551 of 1972, art. 143; *Austria*: Konkursordnung of 1914, § 45; *Chile*: Ley de quiebras of 1931, art. 90 para. 1; *England*: Sale of Goods Act, 1893, s. 46; *France*: Loi no. 67-563 of 1967, art. 62 para. 1; *Federal Republic of Germany*: Konkursordnung of 1877, § 44; *Italy*: Decreto sul fallimento of 1942, art. 75; *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *Spain*: Commercial Code art. 909 para. 1 no. 9; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1; *United States*: Uniform Commercial Code s. 2-705 (3) (b).

The seller is entitled to retain the goods until he has received payment.

Expressly *Chile*: Ley de quiebras of 1931, art. 90 para. 2; *England*: Sale of Goods Act, 1893, s. 44.

Some countries which permit the right of stoppage only in the event of the buyer's bankruptcy, allow the trustee in bankruptcy to object to the seller's repossession, provided the purchase-price of the goods is being (fully) paid to the latter.

Argentina: Ley de concursos no. 19 551 of 1972, art. 144 no. 2; *Chile*: Ley de quiebras of 1931, art. 96; *Federal Republic of Germany*: Konkursordnung of 1877, §§ 44 par. 2, 17; *Italy*: Decreto sul fallimento of 1942, art. 75;

Netherlands: Commercial Code art. 239; *Spain*: Commercial Code art. 909 para. 2; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1.

The seller's interests are not thereby adversely affected since under normal circumstances he is more anxious to receive the purchase-price than the goods.

2.4.3.3 *Effect vis-à-vis third persons*

(*a*) The unpaid seller's right of stoppage avails as against the *buyer's creditors*. This rule is obvious in countries which do not allow stoppage until the buyer's bankruptcy.

See *supra* 2.4.3.1 sub (*b*).

But also a few other countries make it reasonably clear that the buyer's bankruptcy does not affect the seller's right of stoppage.

England: Sale of Goods Act, 1893, s. 62 (3); *Scandinavia*: (Uniform) Sales Law of 1905/07, § 39.

(*b*) The position of a *purchaser* from the original buyer is not entirely easy to describe.

Some countries clearly make the seller's right of stoppage subject to prior rights which third persons may have acquired in the goods during their transit.

Argentina: Ley de concursos no. 19 551 of 1972, art. 143 no. 3; *Federal Republic of Germany*: judicial practice; *Italy*: Decreto sul fallimento of 1942, art. 75.

Other legal systems seem to start with the proposition that sales by buyers during transit do not, as a rule, affect the unpaid seller's right of stoppage.

Expressly only *England*: Sale of Goods Act, 1893, s. 47 (1); *Poland*: Commercial Code of 1934, art. 521.

This principle, however, is then cut down by a major exception in favour of purchasers in good faith. If the seller has issued and transferred a negotiable document of title to the buyer who, on the faith of it, resells to a bona fide purchaser, the seller's right of stoppage is lost.

Chile: Ley de quiebras of 1931, art. 91 para. 1; *Czechoslovakia*: Law on International Trade of 1963, § 364 para. 2; *England*: Sale of Goods Act, 1893, s. 47 para. 2; *France*: Loi no. 67-563 of 1967, art. 62 para. 2; *Netherlands*: Commercial Code art. 238 para. 1; *Scandinavia*: (Uniform) Maritime Law of 1891/93, art. 166 para. 2; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 2; (Hague) *Uniform Sales Law* of 1964, art. 73 para. 3. In effect also *United States* where even delivery of the negotiable document to the buyer excludes the seller's right, see *supra* s. 2.4.3.1 sub (a).

The seller may effectively exclude the buyer's right of disposition until payment by a note to that effect on the documents of title.

See (Hague) Uniform Sales Law of 1964, art. 73 para. 3; *Scandinavia*: (Uniform) Maritime Law of 1891/1893, art. 166 para. 2.

However, in practice such a note seems to be very rare.

Where the seller's right of stoppage is lost, some countries provide a subsidiary recourse. If the subpurchaser has not yet paid the purchase-price to the original buyer, the unpaid seller may himself claim payment from the subpurchaser.

Argentina: Ley de concursos no. 19 551 of 1972, art. 145; *Chile*: Ley de quiebras of 1931, art. 91 para. 2; *Netherlands*: Commercial Code art. 238 para. 2.

2.4.3.4. *Practical importance*

It would appear that for some time now the seller's right of stoppage *in transitu* has lost much of its earlier practical importance. This is primarily due to the modern commercial practice of sales against documents. The seller does not now part with the documents of title to goods until he has either received payment or an acceptable letter of credit has been opened for him. The documentary sale thus effectively reduces the problem of the unpaid seller. However, it is not eliminated altogether. According to the trade usages in some countries, the buyer may ask for provisional handing-over of the documents on trust. If the buyer retains the documents, but fails to pay, the unpaid seller may have to fall back on the right of stoppage.

The right of stoppage has also preserved its importance in sales otherwise than under documents.

2.4.3.5 *Conclusions*

The conditions and effects of the seller's right of stoppage *in transitu* are by and large very similar.

(a) *Conditions*. Two conditions are usually required, one relating to the location of the goods, the other to the financial status of the buyer. There is unanimity that the goods must have been dispatched by the seller, but must not yet have reached the buyer or his agent. Delivery of a negotiable document of title, especially a bill of lading, does not affect the seller's right of stoppage in most countries. This is also the better rule since it is not intelligible why delivery of such a document should adversely affect the seller.

Three different criteria are used to define that financial position of the buyer which creates the seller's right of stoppage, namely the buyer's bankruptcy, his insolvency or a serious deterioration of his economic position. It would seem that the middle solution is the best because it turns on a highly relevant fact situation which is, in general, easy to determine.

(b) *Effects*. Everywhere the right of stoppage entitles the seller to prevent delivery of the goods to the buyer and to reclaim their possession.

If the buyer is in bankruptcy, the trustee in bankruptcy should be allowed to object to the seller's repossession, provided the outstanding purchase price for the goods is fully paid to the seller.

Clearly, the seller's right of stoppage should be effective as against the other creditors of the buyer.

As regards purchasers from the buyer, it would seem that these should be protected against the seller's right of stoppage if they have acquired the goods sold from the buyer without knowledge that the seller had not yet been paid. This should be so in particular, but not only, if the seller has delivered a negotiable document of title to the buyer and the purchaser has acquired on the faith thereof.

2.4.4 *Seller's protection after delivery of goods*

The degree of protection, if any, of the unpaid seller after the buyer has obtained delivery of the goods sold, differs considerably in the various legal systems.

The legal bases of any protection granted also vary considerably. They range between the seller's ownership (which under the so-called cash-sale-doctrine does not pass before payment of the purchase-price); a right to reclaim the goods; and a mere privilege.

As in other parts of this study, all these various rules, however designated, are analysed here from a functional point of view, i.e. we analyse the practical results which ensue from their application.

2.4.4.1 *Lack of protection*

In several legal systems there is no statutory protection available to the unpaid seller after delivery to the buyer of the goods sold:

Especially *England*, but essentially also *Austria, Federal Republic of Germany, Scandinavia* and *Switzerland*.

It is probably no accident that most of these countries at the same time liberally permit the seller to create contractual security interests, like reservation of ownership or hire purchase, without imposing burdensome formal requirements such as the drawing up of formal documents or registration.

Only *Switzerland* requires registration of a contractual reservation of ownership.

Thus the credit-extending seller is in a position to provide easily for his own protection.

The unpaid cash seller, on the other hand, who will not go to the trouble of creating a security interest, is left without any assistance.

2.4.4.2 *Conditions of protection*

Where the seller is protected, this protection depends upon several factors which are differently handled and variously combined in each legal system. Of these factors the most prominent are the location of the goods sold, the buyer's financial position, and the terms of the sale.

(a) *Location of goods.* The special régime of seller's protection after delivery of the goods presupposes that the buyer (or his agent) has obtained possession of the goods.

Brazil: Decreto-Lei no. 7 661 on bankruptcy of 1945, art. 76 § 2; *France*: Civil Code art. 2102 no. 4; *Italy*: Civil Code art. 1519 para. 1; *Mexico*: Nueva ley de quiebras of 1942, art. 159 no. III (impliedly); *Netherlands*: Civil Code art. 1190; Commercial Code art. 232 (in case of bankruptcy); *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *Scandinavia*: (Uniform) Sales Law 1905/07, § 41 para. 1; *Spain*: Commercial Code art. 909 no. 8; *United States*: Uniform Commercial Code s. 2-702 (2).

In some cases, special time-limits govern the buyer's obtaining of possession. Thus in certain Central and North European States this must be *after* the buyer has been declared a bankrupt.

See the *Austrian, German* and *Swiss* provisions cited *supra*, 2.4.3.1 sub (a); *Scandinavia*: (Uniform) Sales Law of 1905/07, § 41.

The seller's protection here is obviously treated as a prolongation of his right of stoppage *in transitu*.

Brazil, on the other hand, requires that the buyer must have received the goods within the fortnight immediately preceding the presentation of the application for bankruptcy of the buyer.

Brazil: Decreto-Lei no. 7 661 on bankruptcy of 1945, art. 76 § 2.

The underlying idea is probably to protect only credit-sellers who have delivered during the critical 15-day period immediately preceding bankruptcy who are likely to have been deceived about the buyer's solvency.

Possession by the buyer need not necessarily persist at the time the seller invokes his protection. How a subsequent disposition of goods to a third person affects the seller's protection is examined separately (*infra* 2.4.4.4).

(b) *The buyer's financial position* on which may depend the seller's protection is defined in different ways.

Many Latin countries, but also some in Central Europe, use the narrowest and at the same time most specific criterion, i.e. the buyer's bankruptcy.

See the provisions of *Brazil, Mexico, Portugal, Scandinavia* and *Spain*, cited *supra* (a); see also *Mexico*: Civil Code of 1932, art. 2993 no. VIII; see also the *Austrian, Dutch, German* and *Swiss* provisions, referred to *ibidem*.

In the *United States*, insolvency of the buyer suffices.

United States: Uniform Commercial Code ss. 2-702 (2), 1-201 (23).

Even more liberal are *France, Italy* and the *Netherlands*. These countries require no more than non-payment of the purchase-price.

See the *French, Italian* and *Dutch* provisions cited *supra* (a).

This, of course, is but a general prerequisite of the seller's protection.

(c) Many laws differentiate between *cash* and *credit sales*. As a rule, the protection afforded to a seller who has sold on credit is less than that afforded to a cash seller. Many Latin countries entitle the cash seller to reclaim possession of the goods from the buyer,

France: Civil Code art. 2102 No. 4 para. 2; *Italy*: Civil Code art. 1519 para. 1; *Mexico*: Nueva ley de quiebras of 1942, art. 159 no. III; *Netherlands*: Civil Code art. 1191 para. 1; *Spain*: Commercial Code art. 909 para. 1 no. 8,

while a credit seller either has no remedy

As in *Italy* and *Spain*

or enjoys a mere privilege.

France: Civil Code art. 2102 no. 4 para. 1; *Mexico*: Civil Code art. 2993 no. VIII; *Netherlands*: Civil Code art. 1190.

However, another group of countries has opted exactly for the opposite position. Here the credit-seller only is accorded protection.

Brazil: Decreto-Lei no. 7 661 on bankruptcy of 1945, art. 76 § 2; *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *United States*: Uniform Commercial Code s. 2-702 (2).

Again, in the Central and North European countries no distinction is made between cash and credit sales.

Austria, Federal Republic of Germany, Netherlands and *Scandinavia*.

2.4.4.3 *Forms of protection*

The two main remedies are the seller's right to reclaim possession of the goods sold and a privilege entitling him to satisfaction of the purchase-price from the proceeds of the goods.

As was pointed out earlier (*supra* 2.4.4.2 sub (c)), a right to reclaim possession of the goods is in some countries available only in the case of cash sales, in others in the case of credit sales, and occasionally in both cases.

The seller's statutory privilege is less efficient than the right to reclaim and it exists only side by side with (and never without) a right to reclaim, but only in a minority of countries.

France: Civil Code art. 2102 no. 4 para. 1; *Mexico*: Civil Code art. 2993 no. VIII; *Netherlands*: Civil Code art. 1190.

As in the case of stoppage *in transitu*, the buyer's trustee in bankruptcy may in some countries oppose the seller's claim for repossession, provided he pays the purchase-price of the goods in full to the seller.

Federal Republic of Germany: Konkursordnung of 1877, § 44 paras. 2, 17; *Mexico*: Nueva ley de quiebras of 1942, art. 162; *Scandinavia*: (Uniform) Sales Law of 1905/07 § 41 para. 1; *Spain*: Commercial Code art. 909 para. 2; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1.

Some legal systems establish a *time-limit* for the seller to invoke his protection.

The time-limit is in some countries relatively short if the seller has the *right to reclaim* the goods. The period runs from the date of delivery to the buyer and is 8 days in *France*, 10 days in the *United States*, 15 days in *Italy* and 30 days in the *Netherlands*.

France: Civil Code art. 2102 no. 4 para. 2; *United States*: Uniform Commercial Code s. 2-702 (2) (however, there is no limit if a written misrepresentation of the buyer's solvency has been made to the seller within three months prior to delivery); *Italy*: Civil Code art. 1519 para. 1; *Netherlands*: Civil Code art. 1191 para. 1; Commercial Code art. 232 para. 2 (in the case of bankruptcy).

In most of the Latin countries no time-limit has been prescribed.

Thus in *Brazil, Mexico, Portugal* and *Spain*.

Only one country seems to impose a time-limit in the case of a seller's *privilege;* it is liberally fixed at 60 days after the purchase-price becomes due.

Mexico: Civil Code art. 2993 no. VIII.

2.4.4.4 *Effect vis-à-vis third persons*

While the unpaid seller's protection is effective in many countries as against the buyer's creditors, its position as against purchasers from the buyer is more controversial.

(a) Protection as against the buyer's *bankruptcy creditors* is obvious in countries which do not grant protection until (or as well as in) the buyer's bankruptcy.

See *supra* 2.4.4.2 sub (b). See in addition, specifically as regards the seller's privilege, *Netherlands*: See Devel, Pays-Bas p. 10; *Spain*: Commercial Code art. 913 no. 3 and Civil Code art. 1922 no. 1.

Some Romanic countries, on the contrary, follow the French lead and deny protection to the seller in the buyer's bankruptcy.

Expressly *Belgium*: Commercial Code art. 546 para. 1; see also *France*: Loi no. 67-563 of 1967, art. 60. Also *Italy*.

It must be noted, however, that in Belgium and France only merchants can be declared bankrupt.

However, two of these countries enable the sellers of specified goods to achieve protection in the buyer's bankruptcy, but only where he takes the trouble to provide the required publication of his statutory privilege. *Belgium* permits such increased protection for sales of machinery and equipment used in industrial, commercial or artisanal enterprises. The deposit of a bill or any other contract document at the court of the buyer's residence is necessary. The protection inures for five years.

Belgium: Commercial Code art. 546 para. 2-4, as amended in 1957.

In *Italy* only machinery with a sales price in excess of 30,000 Lire (today about $US 51) qualifies for special protection, provided the sales documents are filed with the court at the location of the goods. This protection inures for three years.

Italy: Civil Code art. 2762.

It may be extended to six years if machinery with a purchase-price exceeding 50,000 Lire (about $US 850) is marked with a sign indicating the seller's name, some characteristics of the machine and the name of the court where registration has taken place.

Italy: Law no. 1329 providing for the acquisition of new machines of 1965, art. 6 para. 1.

In the *United States* it is doubtful whether the seller enjoys protection in the buyer's bankruptcy. The text of the original official version of the Uniform Commercial Code s. 2-702 (3) had apparently the (possibly unintended) effect of effacing the seller's protection. About 10 states have therefore amended the text to rectify the position; in 1966 also the official text was changed accordingly.

(*b*) Protection against the buyer's *attachment creditors* is, of course, only relevant in the few countries which grant the seller protection prior to bankruptcy (*supra* 2.4.4.2 sub (*b*)). According to *French* practice the seller cannot, by virtue of his privilege, prevent attachment of the goods sold, but he is entitled to be paid from their proceeds in advance of the unsecured attaching creditors.

France: see Devel, France p. 9.

Italy has expressly provided that the seller's right to reclaim possession of the goods sold is subject to the rights of the buyer's attaching creditors unless it is proved that the latter knew, at the time of attachment, that the purchase-price of the goods was in arrears.

Italy: Civil Code art. 1519 para. 3.

(*c*) A similar rule prevails with respect to the *buyer's landlord*. A few Romanic countries expressly give preference to the landlord's claim for rent, unless it is proved that the landlord knew the buyer had not yet acquired title to the goods in question (or that the purchase-price had not yet been paid).

France: Civil Code art. 2102 no. 4 para. 3; *Italy*: Civil Code art. 1519 para. 2; *Netherlands*: Civil Code art. 1192.

(*d*) More practical and more difficult is the seller's position as against *real estate mortgages* of the buyer, if the goods sold have become fixtures. At least three different solutions can be found.

In *France* and the *Netherlands* the seller's privilege remains unaffected. Yet it appears that an existing mortgage has priority unless the mortgagee, at the time the goods were affixed, knew of the existence of the seller's privilege.

France: see Devel, France p. 9; *Netherlands*: see Devel, Pays-Bas p. 12.

In *Mexico*, on the other hand, the seller's privilege is extinguished.

Mexico: Civil Code art. 2993 no. VIII.

Belgium and *Italy* begin with the same premise.

Expressly *Belgium*: Loi hypothécaire of 1851, art. 20 no. 5 para. 2.

However, they provide for the avoidance of this effect where the sales contract has been publicized. The publicity which is required is the same as that needed to make the seller's privilege effective in the buyer's bankruptcy (see *supra* (*a*)).

Belgium: Loi hypothécaire of 1851, art. 20 no. 5 paras. 2-5, as inserted 1957; *Italy*: Civil Code art. 2462 para. 1; Law no. 1329 providing for the acquisition of new machines of 1965, art. 5.

(*e*) The effect of the seller's privilege as against a *purchaser* varies.

According to *French* practice the privilege ceases upon a disposition by the buyer of the goods sold, even if the purchaser knew of the existing privilege.

France: see Devel, France p. 8.

In the *Netherlands* and the *United States* only a bona-fide purchaser extinguishes the seller's protection.

Netherlands: Civil Code art. 1192a para. 1; *United States*: Uniform Commercial Code s. 2-702 (3).

In *Italy* even a good-faith acquisition will not avail in the case of machines with a purchase-price of more than 500,000 Lire (about $US 850) if these are marked in a special way (*supra* (*a*)).

Italy: Law No. 1329 providing for the acquisition of new machines of 1965, art. 3 para. 4.

France and the *Netherlands* provide a small measure of consolation to the seller where the latter loses his privilege to a subpurchaser: the seller's privilege is made to attach to the buyer's claim against the subpurchaser for the purchase-price.

France: see Devel, France p. 8; *Netherlands*: Civil Code art. 1192a para. 2.

2.4.4.5 *Conclusions*

There is very considerable divergency of opinion as to whether the seller should by statute be protected after delivery of the goods to the buyer at all, and if so, in which form.

(a) *Protection or not?* The first question is whether the unpaid seller should be granted statutory protection even after he has delivered the goods sold to the buyer.

Such statutory protection clearly expresses a prejudice of the legislature in favour of sellers as distinct from any other class of creditors. Such preference offends the general principle of equality. There do not seem to exist any special reasons which would justify the preferential treatment of sellers. These should be referred to the possibility of agreeing on a contractual security interest.

This brings us to a necessary consequence of any abolition of a statutory interest in favour of the seller. Access to the contractual security interests must be facilitated, especially by doing away with any limitations as to the permissible parties and items of security and by eliminating burdensome formal requirements. The credit-extending seller must be enabled to provide easily for his own protection.

We shall now discuss the conditions and effects of a statutory interest in favour of the seller under the assumption that such statutory protection should be preserved.

(b) *Conditions of statutory protection.* The seller's statutory protection depends on three conditions, the location of the goods sold, the buyer's financial position, and the terms of the sale.

The seller's statutory protection presupposes everywhere that the buyer must have received possession of the goods sold. If

a general protection of the seller is intended, qualifications as to the time of receipt are not useful.

Criteria for the buyer's financial condition are either his bankruptcy or his insolvency, while some Latin countries do not require either. The latter solution appears to be indicated if the seller's statutory protection is to have a board coverage.

An interesting cleavage exists with regard to the protection of cash and credit sales. Some countries prefer the cash-seller, leaving the credit-seller with less protection or none at all. Some other countries, on the contrary, only protect the credit-seller. These differences depend upon the scope to be given to the statutory protection. If this is designed as a general protection of any unpaid seller, no distinction at all as to the terms of the contract of sale should be made. If, on the other hand, this régime is to be co-ordinated with the possible contractual security interests of the seller, the statutory régime might well be restricted to cash sales, while credit-sellers can be referred to the possibility of creating a contractual security interest. The decision on this point is also reflected in the fixing of a time-limit for the seller's remedy (see *infra* (*c*)).

(c) *Forms of protection.* The seller has two remedies, viz. the right to reclaim possession of the goods sold and a privilege entitling him to satisfaction of the purchase-price from the proceeds of sale of the goods. In some countries both remedies exist concurrently, while in most countries the seller has only the more effective right of reclamation. It would seem that the latter, as the *majus*, also includes the former, as the *minus*, and that the seller can always opt for this, even if the relevant statute does not say so expressly. Thus, in effect there is no diversity as to the two remedies.

As in the case of stoppage *in transitu*, there is no objection to the buyer's trustee in bankruptcy opposing the seller's reclamation, if he pays the outstanding purchase-price.

The stronger remedy, the seller's right of reclamation, is in some countries limited to a short period of time (between 8 and 30 days) after delivery to the buyer. Other countries do not have such a restriction. In most cases the time-limit on the right of reclamation coincides with the restriction of the seller's protection to cash sales (*supra* (*b*)). At any rate, these two aspects must be co-ordinated.

(d) *Effect as against third persons.* The seller's statutory protection after delivery of the goods sold to the buyer is, in general, weaker than that under the right of stoppage *in transitu*.

Thus some Latin countries deny the seller protection even vis-à-vis other (unsecured) creditors of the buyer; but two of these countries allow the seller at least to obtain immunity in the buyer's bankruptcy by means of filing the sales documents with a court. The seller's position is, of course, most precarious if he has no protection, in the buyer's bankruptcy. To require a filing of the seller's interest is an unwarranted limitation on his *statutory* right.

The same considerations should apply as against attachment creditors of the buyer.

The seller's rights vis-à-vis real estate mortgages are weak, if the goods sold have become fixtures. In most countries the seller's rights become ineffective, at least as against existing mortgages. Two Latin countries permit validation by filing of the sales documents. This solution appears to be appropriate in view of the full publicity that governs rights in real estate.

The seller's protection as against purchasers from the buyer varies from *nil* in one country to protection against *mala fide* purchaser in some countries. The latter solution appears to be in keeping with the general rules of property law.

2.5 *Non-possessory security interests in means of transport*

Since security interests in ships and aircraft are subject to widely accepted international conventions, the present study will be limited to automobiles, containers and railways. It will only deal with special rules deviating from the ordinary rules on security interests.

2.5.1 *Automobiles*

2.5.1.1 *Introduction*

Motor vehicles of all kinds, employed extensively in most countries for business purposes as well as for personal use, are very often acquired upon credit. In many countries automobiles are registered for purposes of inspection or taxation or for general police supervision, and often special documents are also issued for each vehicle. For all these reasons one might well expect that special rules on security interests in automobiles would have developed that differ at least in certain respects from the provisions and rules on security interests in general.

Unfortunately, the special problems connected with security interests in motor vehicles have so far attracted scant attention on a transnational level. Only a study by UNIDROIT on instalment sales in the member countries of the Council of Europe has collected some interesting material.

UNIDROIT p. 122-247.

As far as can be ascertained, a special régime for security interests in automobiles prevails in only a few countries. Most of the special rules that do exist are based upon the aforementioned unique features of automobiles, namely their registration and documentation.

The reasons for special legislation vary from country to country. The *Italian* Decree-Law of 1927 on contracts for the sale of motor vehicles and the original *French* statute of 1934 were passed in order to promote the domestic motor industry by facilitating and securing the selling of automobiles on credit. Perhaps the same reason prompted the enactment of the *Japanese* statute. But none of these Acts was or is restricted to automobiles of domestic production. In other countries, and especially in *South America*, the primary purpose was apparently the desire to protect secured creditors against fraudulent transactions with respect to the encumbered automobile by the debtor.

2.5.1.2 *Admission of other security interests*

Certain countries which provide a special régime for security interests in motor vehicles have in addition a non-possessory security interest of general coverage (especially reservation of ownership). In these countries the question has been debated whether a motor vehicle may still be made the subject of this general non-possessory interest. In both *Italy* and *Japan* court practice has solved this dispute in the affirmative.

Italy: Cass. 10 Sept. 1969, Foro it. 1970.I.149; *Japan*: *Yamada*, Japanische Gesetzgebung auf dem Gebiete des Privatrechts 1945-1958: Rabels Zeitschrift für ausländisches und internationales Privatrecht 26 (1961) 713-730 (722).

Japan, *Portugal* and the *Republic of Korea* (*South Korea*) expressly exclude the pledge of a motor vehicle.

Japan: Law of 1951, art. 20; *Republic of Korea*: Law no. 868 on hypothecation of automobiles of 23 Nov. 1961, § 8; *Portugal*: Decreto-Lei no. 40 079 of 1955, art. 10.

Most other countries are silent on this point. Such silence must be understood as directed against an exclusivity of the non-possessory security interest. Registration and the other means of publication are designed to substitute for the creditor's possession because it is usually impracticable; but it is not to be excluded altogether.

2.5.1.3 *Restrictions as to secured claims*

In keeping with the general restrictions imposed by many countries upon non-possessory security interests (*supra* 2.3.2), the type of monetary claim that may be secured by motor vehicles is sometimes narrowly circumscribed. In *France* and the French-influenced statutes of *Lebanon*, *Morocco* and *Tunisia* only the seller's claim for the purchase-price can be secured.

France: Décret of 1953, art. 1; *Lebanon*: Loi relative à la vente à crédit des autovéhicules ... of 1935, art. 1; *Morocco*: Dahir réglementant la vente à crédit des véhicules

automobiles of 1936, art. 1; *Tunisia*: Décret relatif à la vente à crédit des véhicules ou tracteurs/automobiles of 1935, art. 1.

Except in *Lebanon*, a purchase money loan by a third person may also be registered.

France: Décret of 1953, arts. 1 and 2; *Morocco*: Dahir art. 13 (payment of purchase-price for the buyer by third person after registration); *Tunisia*: Décret art. 1 para. 1.

It is a consequence of this limitation to claims for purchase money (see *supra* 2.3.2.2) that no other contractual security interest in the vehicle may be registered.

Expressly the *French* Ministerial Instruction of 1956, II-C-1.

Italy also covers claims for purchase money and even gives them a preferential treatment by granting a *statutory* security interest in the vehicle.

Italy: Decreto-Legge of 1927, art. 2 paras. 1-2.

But the courts permit a seller to conclude a conditional sale and have the reservation of ownership entered in the register.

Italy: Cass. 10 Sept. 1969, Foro it. 1970.I.149.

In addition, a *contractual* security interest may be created in favour of any other creditor.

Italy: Decreto-Legge of 1927, art. 2 para. 3.

2.5.1.4 *Special systems of registration*

Some countries, irrespective of whether they provide for registration of security interests in general (*supra* 2.3.3.3) or not, have established special forms of registration for automobiles. "Registration" in this context means an entry in a record maintained by some public office that is more or less accessible to public inspection. Entries on documents relating to individual vehicles are dealt with separately (*infra* 2.5.1.5). Registration of security interests either constitutes a prerequisite to their validity, or is simply a means of affording some measure of protection to the secured creditor and third parties.

2.5.1.4.1 *Registration as a condition of validity*

France, Italy, Japan, Lebanon, Morocco, Portugal, South Korea, Tunisia and certain *South American* countries require registration of all security interests in automobiles as a condition of their valid creation. *Finland* and *Norway* require it only for security interests in buses. In these countries registration is a pre-condition for the legal effectiveness of a security interest either vis-à-vis third parties, or sometimes even between creditor and debtor.

(*a*) With regard to the place of registration most countries do not provide for central registration in one single office for the whole country. Rather it is decentralized in offices on the province or district level. Each vehicle that has been licensed in one of these territorial subdivisions must be registered in that subdivision's office. Vehicles licensed abroad are thus impliedly excluded. In some countries, certain public automobiles, those belonging to foreign diplomats and consuls and those circulating duty-free are excluded.

France: Décret of 1953, art. 1 para. 2; *Italy*: Executive regulations of 1927, art. 26.

(*b*) Some countries fix a *time-limit* for registration. This period, which generally runs from the acquisition of the vehicle, varies from 15 days in *Morocco*, two months in *Tunisia*, and three months in *France* to one year in *Italy*.

Morocco: Dahir of 1936, art. 4; *Tunisia*: Arrêté of 1935, art. 8 para. 2; *France*: Décret of 1953, art. 5; *Italy*: Decreto-Legge of 1927, art. 2 para. 7.

(*c*) The *duration* of the registration is limited in many countries to five years, subject to renewal for the same period.

France: Décret of 1953, art. 2 para. 5; *Italy*: Decreto-Legge of 1927, art. 2 para. 5, art. 18; *Tunisia*: Décret of 1935, art. 4.

In other countries, there is apparently no time-limit.

(*d*) Certain countries provide for *double publication*. In addition to registration, they also require an entry in a document which remains with the vehicle. Thus in *Italy*, a notation corresponding to that in the register is entered into a supplement to the vehicle licence which stays with the vehicle.

Italy: Decreto-Legge of 1927, art. 16.

In *Lebanon, Morocco, Spain* and *Tunisia*, the security interest is also annotated on the vehicle licence (*carte grise*).

Lebanon: Law of 1935, art. 23; *Morocco*: Dahir of 1936, arts. 4 and 5 para. 1; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 35 para. 4; *Tunisia*: Décret of 1935 art. 5.

Spain emphasizes the intimate relation between the two registrations by entering the class and number as well as date and place of issue of the vehicle licence in the register.

Spain: Executive regulation of 1955, art. 20 no. 1.

In *Argentina* and *Portugal*, a "certificate of title" is issued, in which registered security interests must also be entered.

Argentina: Decreto-Ley no. 6582 sobre régimen legal de los automotores of 1958, art. 7, 19 para. 2 sub *a*; *Portugal*: Decreto-Lei no. 40 079 of 1955, art. 20.

(*e*) The *effects* of registration are limited, in general, to the relations between the secured creditor and third persons. In most countries, the *French* rule prevails according to which the security interest is ineffective vis-à-vis third persons unless and until registered.

France: Décret of 1953, art. 5; to the same effect; *Brazil*: Lei no. 2931 of 1956, art. 2; *Japan*: Law of 1951, art. 5 para. 1; *Lebanon*: Law of 1935, art. 8 para. 1; *Morocco*: Dahir of 1936, art. 4; *Portugal*: Decreto-Lei no. 40 079, art. 13; *Tunisia*: Décret of 1935, art. 1 para. 1.

In *Italy*, the effect of registration seems to be slightly narrower. According to the statute, registration is effective only as against any subsequent owner or possessor of, or holder of any right in, the vehicle, provided the latter's rights are, if necessary, also duly registered.

Italy: Decreto-Legge of 1927, art. 2 para. 6; art. 6 para. 1.

Thus, registration does not seem to affect unsecured creditors of the debtor who wish to enforce a money-claim against an encumbered car.

Argentina, on the other hand, clearly spells out that the very existence of the encumbrance depends upon its registration.

Argentina: Decreto-Ley no. 6582 of 1958, art. 7 sent. 2.

Countries are divided as to the effect of registration on transactions concerning the vehicle by the owner. On the one hand, in *France* registration of the security interest does not prevent the transfer of title to the encumbered automobile and registration of this transfer.

France: Ministerial Instruction 1956, no. VI-A.

On the other hand, in *Bolivia* registration precludes any transfer of the vehicle by the debtor to another person. Any transfer may only be registered if a certificate of "no encumbrances" has been issued by the registration office.

Bolivia: Decreto 5608 of 1960, art. 12.

This strict rule is to be explained by the general purpose of the South American statutes to prevent fraudulent transfers of encumbered vehicles.

2.5.1.4.2 *Registration as a protective device*

As distinct from its objective of being a condition of validity, registration may merely serve a protective function, the emphasis being on protecting either the secured creditor or third parties. Thus under some systems, registration of a security interest merely adds to the protection which the secured creditor enjoys against inroads by third parties under the law generally. Registration is of even lesser import in other systems where it merely serves to apprise third parties of existing security interests, without improving the secured creditor's position.

The protective function of registration appears to be particularly well developed in *Cyprus*. The names of automobile owners must be entered into the register of motor vehicles. Rule 14 of the Motor Vehicles Regulations, 1959 and 1965

permits entry not only of the "registered owner" (the actual possessor) of the car, but also of its "absolute owner" (i.e. the legal owner who may be a seller or a lending bank). The absolute owner may apply for registration and will be registered unless the "registered owner", who is informed of the application by the registrar, objects. In case of such an objection the registrar, after investigating the facts, makes a ruling thereon. In practice, the registration of the absolute owner in effect prevents any voluntary or forced transfer of rights in the car without his consent.

Malta's system differs slightly in that only one person may be registered as the owner. In practice, usually the credit seller is entered in the register and on the licence. If the seller/creditor wishes to avoid liability for traffic offences of the buyer/debtor, the latter's name may be entered in both the register and the licence, but with a notation in the register that the creditor's agreement is required for a transfer of the vehicle. In both cases, a purchaser's good faith as to the debtor's title is destroyed. The system of entering the buyer with a notation in favour of the creditor is also followed in *Turkey* (where it exists in addition to the general registration of seller's security interests).

The system of private registration in *England* is of even lesser consequence. The great majority of companies engaged in financing automobiles report any hire purchase transaction to a private information centre, "H.P. Information, Ltd.", which in turn offers this information for a small fee to anybody requesting it. However, this registration has no *legal* effects. Acquisition of title from a non-owner by a private purchaser is only excluded by actual notice of a security interest in an automobile (s. 27 para. 2 Hire-Purchase Act 1964, c. 53), whereas registration constitutes constructive notice at most. "Trade and finance purchasers", on the other hand, cannot acquire *bona fide* status at all. Thus registration is not intended to improve the secured creditor's position, but helps to warn commercial purchasers and lenders against the acquisition of, or lending upon, a motor vehicle already encumbered. It is obvious that this system can only work as between commercial lenders because the benefit of registration inures to the potential third parties and not to the registrant. Indirectly, of course, the secured creditor also benefits from the restraint against the acquisition of encumbered vehicles.

Chile permits the annotation of security interests affecting an automobile that are entered in their respective registers.

Decreto no. 1.151 approving the regulations of the Motor Vehicle Register of 1963, art. 13 para. 2.

This also seems to be a purely protective entry, without affecting the validity of the security interest.

2.5.1.5 *Vehicle documents as means of publication*

The various documents issued for automobiles are used in rather different ways for the purpose of giving notice of security interests. As in the case of registration (see 2.5.1.4), the documents may be instrumental in either creating a valid security interest or in simply affording some protection to the secured creditor and/or third parties.

In more than 35 states of the *United States*, the relevant document issued for an automobile is a "certificate of title" which must be distinguished from the registration card which is required for use of the vehicle on the highways. Certificates are usually not issued for new cars until they are sold to a person other than a dealer. Entries on the certificate are usually conclusive evidence of ownership and of other rights existing in the vehicle. All kinds of security interests can thus be noted on a certificate. In the so-called full-title States, a security interest is not perfected unless it is noted on the certificate. The certificate—as distinct from the registration card—does not remain with the encumbered car, but is delivered by the issuing office to the best ranking secured creditor. Thus the certificate provides much less publicity than the Uniform Commercial Code's general register of security interests—but nevertheless, under UCC s. 9-302 (3) (*b*), notation on a certificate of title is deemed equivalent to filing under the Code. In fact, the mere absence of a certificate will put a purchaser or lender on notice that the car may be subject to a security interest.

In *India*, a security interest may be entered in the certificate of registration. As long as this registration stands, a transfer of ownership of the vehicle may only be registered with the creditor's written consent.

Motor Vehicles Act, 1939, s. 31 A (added by Act of 1969).

The Motor Vehicle Rules of the various states expressly state that such registration does not affect the title of any party.

E.g., *Assam* Motor Vehicle Rules, 1940, s. 55 (*a*).

Very different is the use made of vehicle documents in the Federal Republic of Germany and Austria. In *the Federal Republic of Germany*, both a licence and a "motor vehicle letter" are issued, each of which states the owner's name. However, neither transfer of the letter nor entry of a new name are preconditions for a valid transfer of ownership or the creation of a security interest in a car, although under administrative rules the letter must be handed over to a new owner. Nevertheless, the practice has developed that a secured creditor will retain or demand possession of the letter as "security". The courts have concluded from this practice that a purchaser or a lender who does not demand the letter from the present holder of the car, or does not obtain it upon such a demand, must be regarded as being grossly negligent in believing the possessor to be the owner. A *bona fide* acquisition of title to, or of a new security interest in, the car is thus excluded. The *Austrian* procedure is very similar. An analogous solution had also been envisaged for the English Hire-Purchase Act of 1964, but was rejected by the finance companies as being more expensive than the losses sustained through unauthorized sales by their debtors to private purchasers.

In certain countries (especially *Argentina, Italy, Malta, Morocco, Portugal, Spain* and *Tunisia*) a security interest is both registered and annotated in the vehicle documents (*supra* 2.5.1.4.1 and 2.5.1.4.2).

2.5.1.6 *Special rules unrelated to publication*

Apart from rules on publication one finds in some countries different special statutory rules relating to other aspects of security interests in automobiles. These rules do not show any uniform pattern or trend. Rather, they appear to be *ad hoc* provisions designed to remedy specific shortcomings of the general rules on security interests, as applied to motor vehicles. Nevertheless, a cursory glance at the more significant of these special rules is appropriate.

2.5.1.6.1 *Extension of the security interest*

In keeping with the general rules (*supra* 2.3.4.2) several statutes extend the security interest in an automobile to insurance claims of the debtor that may arise from destruction of or damage to the encumbered vehicle.

Italy: Decreto-Legge of 1927, art. 3; *Japan*: Law no. 187 of 1951, art. 8; *Finland*: Law of 1950, § 6; *Spain*: Ley de hipoteca mobiliaria of 1954, arts. 5 and 6; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 7.

In *Italy* this rule also covers a claim arising from the requisitioning of the vehicle, and in *Japan* it extends to the purchase price for a transfer of the car.

The rules extending the security interest to insurance claims of the debtor are of particular relevance for the creditor if the encumbered car is by force of law brought under the coverage of insurance. Such obligatory insurance exists especially in *Italy, Portugal, Spain* and *Venezuela*, although with rather different characteristics.

The *Italian* rules have two peculiarities. First, the obligatory insurance does not cover the car, but the debtor's liability towards third persons for damage caused by the vehicle. The insurance must be at least as high as the creditor's secured claim and must be taken out for the duration of the security interest. Second, it is the creditor who is obliged to take out the insurance for the debtor (although he may require the

debtor to reimburse him for the premiums paid). If the creditor fails to take out the insurance, the creditors of damage or injury claims may disregard the security interest.

Italy: Decreto-Legge of 1927, art. 4.

Clearly, this whole regulation is designed to protect victims of traffic accidents by making available to them an unencumbered fund at least equivalent to the value of the car. In view of the widespread modern tendency to require by statute that all car owners carry liability insurance, the Italian regulation seems to be outdated. Only for countries without obligatory liability insurance is this approach still of interest.

More in keeping with present-day conditions is the *Spanish* regulation which demands that every vehicle be insured against loss or damage, at least in the amount of the secured claim.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 36; similarly *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 37.

The number of the insurance policy as well as its amount must even be entered in the register.

Spain: Executive regulation of 1955, art. 20 no. 2.

In view of the risks to which all cars are subjected, this obligatory insurance effectively increases the secured creditor's security.

Portugal combines the Italian and the Spanish approach by requiring both liability and loss and damage insurance, however without establishing minimum limits.

Portugal: Decreto-Lei no. 40 079 of 1955, art. 8.

Apart from statute, many secured creditors will insist in their contract upon such insurance of the car by the debtor.

2.5.1.6.2 *Enforcement of the security interest*

Numerous special provisions relate to the enforcement of security interests in automobiles.

Italy has the most comprehensive scheme of enforcement, which operates as follows. After the secured claim has fallen due, the creditor may apply for a judicial attachment and fixing of a date for public or private sale. If the debtor at the first hearing—which takes place within a short time after attachment—does not produce written proof of payment of the amount due, the enforcement sale is judicially decreed (Decreto-Legge of 1927, art. 7 paras. 2-3). Elaborate rules are to be observed in case of a *private* sale (Executive regulations of 1927, art. 27).

In *France*, art. 3 of the Decree of 1953 refers for enforcement of the creditor's rights to art. 93 Commercial Code, whether or not the debtor is a merchant. Under this provision the creditor may proceed, eight days after having given notice to the debtor, with a public sale of the vehicle. However, the creditor may also follow the more cumbersome general procedure set up for the enforcement of a "civil" pledge which is sometimes more advantageous for him.

In *Morocco*, the judge, upon non-performance by the debtor, orders return of the car to the creditor. If the parties are not satisfied with the price-estimate by the judicially appointed appraiser, the car must be sold at public auction.

Morocco: Dahir of 1936, art. 8.

Rather elaborate provisions exist in *Lebanon*. Execution may only be demanded after two consecutive instalments have fallen due and the debtor has been formally put in default. The creditor may demand either return of the car or its public sale. In the former case, a judicially appointed expert has to fix the present value of the car.

Lebanon: Law of 1935, arts. 10-20.

Ireland has enacted two special rules designed to facilitate recovery of an automobile by the secured creditor. First, in derogation of the general rules, the buyer may authorize the creditor to enter buildings (except those used for dwelling purposes) in order to repossess a vehicle. Second, a creditor who has applied for a court order for repossession of a car (which is necessary if the buyer has paid one third of the purchase price) may personally repossess the car before issuance of the order, if the buyer has abandoned the vehicle or has left it unattended and damage has resulted or is likely to result therefrom.

Hire-Purchase (Amendment) Act, 1960, (no. 15), s. 16.

In the Canadian province of *British Columbia* the seller of an automobile under reservation of title may fix for the public auction at which the car is to be sold after the buyer's default a so-called "reserve price" (which must not surpass the buyer's outstanding debt). If no bid at the auction meets this price, the seller may withdraw from the auction and demand payment of the reserve price, plus the cost of the auction from the buyer within seven days. If the buyer does not pay, his rights in the car are extinguished, and the seller becomes its absolute owner.

Conditional Sales Act, s. 14 para. 8.

2.5.1.7 *Comparative analysis*

An analysis of the various special rules existing in certain countries on security interests in automobiles reveals that some of these rules are more or less accidentally connected with motor vehicles, while others are intimately bound up with them.

It would seem that all the rules unrelated to publication of security interests (*supra* 2.5.1.6) are designed to remedy specific shortcomings of a particular country's general rules. They do not derive of necessity from the nature of a car as an object of security. This conclusion is supported both by the very few countries that have adopted any of these rules and by the fact that many of them are identical with rules which in other countries belong to the general body of security law (*supra* 2.3). Thus we need not deal further with these rules here.

The situation is different for the special rules relating to publication of security interests in motor vehicles. The fact that public authorities in many countries, for purposes of taxation, inspection and supervision, register automobiles and/or issue documents in connexion with this registration, is an obvious point of departure for the publication of security interests. A considerable number of countries have made use of this possibility, either (1) in place of an existing system of registration for movables in general (*United States*); (2) as one of several other specialized systems of registration (*France*); or (3) as a unique specialty as compared with the unpublicized creation (*Italy, Finland*) or protection (*Austria, Cyprus, Germany, Federal Republic of, Malta*) of security interests in other movables. The simplest method is certainly the use of existing vehicle documents as a protective device, as exemplified in *Austria* and the *Federal Republic of Germany*. It requires no administrative investment by the authorities and hardly any effort by the parties and is thus particularly inexpensive. Slightly more administrative effort is connected with registration for protective purposes, as practised in *India, Cyprus, Malta* and *Turkey*. Both of these protective measures guard against the greatest risk of the creditor, namely disposal of the vehicle by the debtor. Where registration or documentation are conditions of validity of a security interest (as in *Bolivia, Finland, France, Italy, Japan, Lebanon, Morocco, Portugal, Spain* and *Tunisia*, as well as in the *United States*), the administrative expenses and therefore the cost of the security are considerably higher. It is doubtful, however, whether this higher price is matched by better protection of the creditor (except in a country with a general system of registration of security interests, as the *United States*).

It would thus seem that utilization of existing forms of registration and documentation of vehicles for purposes of policing is a simple and relatively effective means of providing some publicity to security interests in motor vehicles. However, as will immediately be seen, an effective protection of security interests against unauthorized border-crossings with the consequent risk of loss is only possible on the basis of a somewhat refined system of documentation.

2.5.1.8 *International aspects*

The special provisions on security interests in automobiles described thus far assume a purely domestic transaction in

which no foreign elements come into play. However, worthy of mention are the provisions of a few countries which have anticipated the influence of international aspects.

Several very narrow provisions envisage the fact that probably millions of automobiles annually cross international borders. *Finland* and *Venezuela* forbid the debtor to take an encumbered vehicle over the borders of the country without the written permission of the secured creditor.

Finland: Law of 24 Nov. 1950, § 8 para. 4; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 37.

It is doubtful whether the creditor can effectively assure the observation of this prohibition. *Morocco, Portugal, Spain* and *Argentina* have accordingly refined this approach. *Spain*, like *Finland*, requires the creditor's permission. But Spanish law adds the requirement that customs must demand the vehicle licence in which the security interest is annotated (*supra* 2.5.1.4.1) in order to ascertain whether the creditor has consented.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 37.

A similar solution is envisaged by the *Argentine*, the *Moroccan* and *Portuguese* statutes.

Argentina: Decreto-Ley sobre régimen legal de los automotores of 1958, art. 29; *Morocco*: Dahir of 1936, art. 14, inserted in 1957; *Portugal*: Decreto-Lei no. 40 079 of 1955, art. 29.

All these provisions are obviously inspired not only by the desire to preserve a certain physical control by the creditor, but also by the fear that a national security interest may not be recognized abroad. It should also be noted that both the Argentine and the Spanish rules require a document relating to security interests that can be presented to the custom authorities.

Italy has provided for another possible international aspect of a security transaction, namely the formation in a foreign country of the contract which gives rise to or creates the security interest. Such a document must be authenticated before it can be submitted for registration in Italy.

Decreto-Legge of 1927, art. 17 para. 3.

One may well doubt whether such a case occurs frequently.

Apart from these statutory rules envisaging a foreign element in connexion with a security interest in an automobile, the other special rules probably assume impliedly a purely domestic transaction. However, it would not seem impossible that they are also applicable if certain foreign elements were involved. Thus, certainly the nationality of creditor and debtor is irrelevant as are, theoretically at least, the residences of the parties. In reality, at least the residence of the debtor who holds the motor vehicle will be in the country in which the vehicle is registered. In practice, moreover, the creditor's residence will also be in that country because neither sales nor credit transactions "over the border" occur in fact, at least in relations with private persons. In the marketing of new cars for distribution in countries outside that of the car manufacturer, the cars themselves are not used as the object of a security interest to secure the manufacturer or other seller.

Different and difficult problems arise if a car subject to a security interest created in one country is afterwards brought to another country and the recognition or enforcement of the security interest then becomes necessary. These problems raise issues of conflict of laws and will be dealt with elsewhere (*infra* 3.3).

2.5.2 *Containers*

Containers which are today used to facilitate the international traffic of goods, are endowed with a high degree of mobility. Their acquisition is frequently financed by the container manufacturers or distributors. Since many containers, particularly those transported by aircraft or ship, continually cross national borders, the question of the international status of security interests in containers would seem to be a highly relevant problem. Apparently, however, this question has not yet attracted much public attention. In the present context we can merely draw attention to this new problem and intimate that a uniform régime would seem to be desirable.

2.5.3 *Railway rolling stock*

2.5.3.1 *Introduction*

While railways had been the primary means of transportation in many countries for decades, their economic role has declined in many parts of Europe and North America since the Second World War. But in other countries of vast distances they still are the most important means of transportation. In most countries the vast majority of railways are today state-owned. These factors diminish in some countries present need for secured financing of railways.

On the other hand, certain factors indicate that the financing of railway rolling stock has retained some importance, not only in national perspectives, but also on the international level. One factor is the acute demand for expansive new rolling stock which is often imported and bought on credit. Another factor is the relatively significant number of "private" railway cars, particularly freight cars with special equipment. These cars are very often not owned by the state railways or the private railroad companies, but by companies which use them for their own needs or hire them to users.

The share of "private" freight cars amounted to 16 per cent in France (1960) (see Rodière, *Droit des transports* III 2 (1962) no. 1423) and to 13 per cent in the United States (1948) (*Encyclopaedia Britannica* XVIII 923).

Both the sale of rolling stock, which is often on credit, and its utilization very often have international aspects. In the *socialist* countries of Eastern Europe, however, there are no private cars nor is there any need to secure the credit, if any, for the acquisition of rolling stock.

The special treatment of railroad rolling stock for other countries is both justified and necessitated by the rather specialized legal rules that exist in many countries and the special practices that have developed in others. Unfortunately, national literature in this specific area is extremely sparse, and is practically non-existent on a comparative level. The picture must, therefore, of necessity be incomplete.

2.5.3.2 *Application of the general rules*

Unless the encumbrance of railroad rolling stock is subject to special rules (*infra* 2.5.2.3), or is expressly prohibited or restricted (*infra* 2.5.2.4), it must be assumed that the general rules on security interests apply (*supra* 2.3).

Specific authority for this assumption is difficult to adduce. Suffice it to mention two provisions of the *Spanish* statute on mortgages in movables. One includes, among the objects that may be encumbered, privately owned railway cars. The second sets out the identifying characteristics of such cars to be entered in the register.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 34 para. 2 and art. 35 para. 2; similarly *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 35 para. 2.

2.5.3.3 *Special rules*

The only country which produced a special body of rules for security interests in railroad rolling stock appears to be the *United States*. In keeping with the general formation of the unwritten common law, the American rules evolved in practice using the general framework of the trust and were only later codified in state statutes. These rules were thought to be so original and peculiar that, until 1972, even the Uniform Commercial Code (originally adopted 1952) has expressly refrained from regulating this particular security interest. UCC s. 9-104 (e) of the 1962 edition of the Code excluded "an equipment trust covering railway rolling stock" from the general provisions of the Code.

The most important financial and legal aspects of the equipment trust in railroad rolling stock are briefly as follows. Upon delivery of new rolling stock by the manufacturer, the railway makes a payment of 20-25 per cent. The rest of the purchase

price is paid by a finance corporation which receives title to the equipment as trustee and sells to the public certificates representing *pro rata* shares of the equipment. The latter is leased by the finance corporation to the railway. Within 10 to 15 years the railway repays capital and interest on the certificates. Upon complete payment it receives title to the equipment.

See *Duncan*, Equipment Obligations (New York, London 1924).

All the states of the *United States* enacted legislation affirming the validity of these equipment trusts, on condition of their being filed in the appropriate state (or local) registry office. In 1952, the *United States*, following the example of *Canada*, established the possibility of federal registration, to be effective for the whole country.

Canada: Railway Act, s. 86; *United States*: Interstate Commerce Act § 20c, as added 1952.

The Federal Government has made equipment trusts privileged in other respects as well. Contrary to all other securities, equipment trusts are not affected by railroad reorganizations in bankruptcy nor by modifications of the financial structure of railroads by the Interstate Commerce Commission.

United States: Bankruptcy Act Section 205 (*j*) last sentence; Interstate Commerce Act § 20b (*l*).

By 1972 exclusion of the railway equipment trust from the all-comprehensive security interest rules in article 9 UCC (*supra*), which apparently rested originally on reasons of convenience rather than necessity, was no longer deemed useful. Therefore, this exclusion was eliminated and the railroad equipment trust was brought under the coverage of the general provisions on security interests (maintaining, however, the federal registration).

2.5.3.4 *Restrictions upon security interests*

The laws of many countries place restrictions upon security interests encumbering railway rolling stock. These restrictions are generally imposed in the public interest in order that the operation of a railway may not be hindered by disputes concerning creditors' rights. The restrictions affecting security interests relate partly to their creation and partly to their enforcement.

2.5.3.4.1 *Restrictions upon creation of security interests*

A typical example of a regulation issued for the protection of public interests is to be found in *Italy*. The movable property of the state railways which is indispensable for their operation has been declared "immovable by destination" and thus indisposable.

Italy: Mocci, Ferrovie dello Stato: *Novissimo digesto italiano* VII (1961) 237 no. 14.

It is likely that a similar rule prevails in many countries of the Latin orbit.

In a number of other countries there is a more juridical obstacle to the creation of security interests in rolling stock. These countries do not exclude outright the creation of such security interests. However, they offer a special scheme for encumbering the whole railway, especially its immovable property, but including the rolling stock, through creation of a "railway estate". The estate that has to be registered comprises all the rolling stock existing at the time of its creation and including after-acquired equipment.

Austria: Law of 1874, § 5 para. 2 litt. c); in parts of the *Federal Republic of Germany*: Prussian law on railway estates of 1902, § 4 para. 1 no. 3; *Japan*: Railway Hypothecation Law (no. 53) of 1905, as amended, art. 3, no. 6, art. 11 para. 1; *Norway*: Law amending legislation on pledges of 1895, § 2 para. 3 (for railways serving the public); *Sweden*: Law on introduction of the new Immovables Law of 1970, § 9 para. 1 in connexion with Regulation of 1880, § 1 para. 2 sent. 1; *Switzerland*: Federal Law on Hypothecation and Forced Liquidation of Railway and Shipping Enterprises of 1917, art. 9 para. 2 litt. b), art. 11 para. 1.

After such a railway estate has been mortgaged, the creation of security interests in rolling stock appears to be excluded, as in the case of the *Italian* prohibition.

The "railway estate" in the above-mentioned countries is rather similar to a floating charge of the English type established on the undertaking of a railway company and comprising all, or almost all, of its immovable and movable property (see *supra* 2.3.4.3). Such floating charges are expressly authorized for railway companies in *Canada*.

Canada: Railway Act, ss. 75-77. Section 78 declares federal registration to be effective for all Canada, unless a (provincial) Act expressly requires an additional form of publication.

However, even without such authorization they would seem to be valid wherever the rules of the English Common Law are applicable in this respect.

Another question is whether both in *Italy* and in the countries just mentioned a security interest, especially a purchase money security interest, that already existed when the equipment was acquired by the railway, would remain valid even after the acquisition. Lacking special rules or judicial authority it would seem under general principles of law that the answer must be in the affirmative. The acquisition and putting into operation of rolling stock cannot result in an expropriation of acquired rights, unless the contrary is clearly enunciated.

2.5.3.4.2 *Restrictions upon enforcement of security interests*

The Federal Republic of Germany requires authorization by the supervisory state agency for the secured creditor to enforce his security interest in rolling equipment of private railways which serve the public traffic.

Federal Republic of Germany: Law of 7 March 1934, as amended, § 4 para. 1.

This provision clearly limits the secured creditor's rights.

A related protective rule, found in *England* and the *Federal Republic of Germany*, may indirectly inure to the benefit of a secured creditor. In both countries any execution against the rolling stock of a railway that is open to the public is prohibited.

England: Railways Companies Act, 1867, s. 4; similar statutes exist in many Commonwealth countries, see e.g. *India*: Indian Railways Act, 1890, s. 136; *Australia*: state of *Victoria*: Railways Act 1958 s. 199.

Federal Republic of Germany: Law of 3 May 1886; see also Federal Railways Law of 1951, as amended, § 39 par. 1 (an execution against the Federal Railways is subject to authorization by the Federal Government).

However, in the absence of special statutory rules of this protective character one must assume that no restrictions are imposed upon the execution of rolling stock.

France: see Thévenez, d'Hérouville, Bleys, *Législation des Chemins de Fer* (Paris, 1930) I 432.

2.5.3.5 *Conclusion*

The legal rules governing security interests in railway rolling stock emphasize the restrictions imposed on these interests. These restrictions are dictated by the superior interest of the public in the proper and uninterrupted operation of the public railways, to which the "merely" private financial interests of an individual secured creditor are subordinated.

2.6 *Uniform rules of substantive law*

Having noted in our analysis of security interests on a national basis the vast divergencies in the different systems, the question arises whether any legislative attempts have been made, or other proposals submitted, to achieve some measure of uniformity in this field.

2.6.1 *Legislative attempts at unification*

We shall first consider the attempts at achieving some uniformity through legislation; up to now, none of them have succeeded.

2.6.1.1 *Scandinavian conditional sales act*

The three Scandinavian countries Denmark, Norway and Sweden enacted during 1915-1917 a (uniform) conditional sales

act elaborated within the general framework of Nordic legal co-operation.

English text of the Swedish statute in Zweigert/Kropholler, *Sources of International Uniform Law I* (1971) E 159.

However this uniform act does not deal with the proprietary aspects as against third persons of conditional sales, but is restricted to relations between seller and (instalment) buyer *inter se*. The statute therefore regulates essentially the instalment aspects of conditional sales and has little relevance for commercial sales.

2.6.1.2 *UNIDROIT draft of 1939/1951*

In the course of its efforts to unify the law of international sales, the International Institute for the Unification of Private Law in Rome (UNIDROIT) has also for some time considered the possibility of elaborating uniform rules on sales with reservation of ownership in goods. Appendix I to the 1939/1951 Draft of a Uniform Law on International Sale of Goods (Corporeal Movables)

See *L'Unification du Droit/Unification of Law 1948*, p. 102 ss. 149-151, submitted to the Hague Conference of 1951,

Actes de la Conférence ... sur un projet de convention relatif à une loi uniforme sur la vente d'objets mobiliers corporels 1951 (1952) p. 53,

contained nine provisions dealing with this subject.

The draft is limited to international sales as defined by the main text (art. 1). In essence it covers only international sales of machines (art. 2), all other goods being made subject to the law of the country of importation. The agreement as regards reservation of ownership was required to be in writing (art. 3). The publicity measures, especially any registration requirements of the country of importation necessary to give validity to the reservation or to enable it to be set up against third parties, were required to be observed (art. 4).

Where the seller knows that the goods have been purchased for resale, the reservation of his ownership is to lapse as soon as the subpurchaser has received the goods or a document of title covering them (art. 5). The reservation of ownership is to be effective in the buyer's bankruptcy or as against attachment creditors of the buyer (art. 6). Apart from the aforementioned cases, the "competent national law" shall determine whether and in what circumstances third persons can acquire rights over the goods which have priority over the seller's ownership (art. 7).

In the event of the buyer's default in payment the seller is permitted to retake the goods only if he is both entitled to rescind the contract of sale and has done so (art. 8). Privileges created by the national law in favour of the seller are preserved and shall coexist with the agreed reservation of ownership (art. 9).

The Draft is thus a combination of uniform rules of substantive law (form of the agreement, art. 3; effects upon items for resale, art. 5; effects in bankruptcy and upon attachment, art. 6; retaking by the seller, art. 8), conflict rules proper (in general, the law of the country of importation, art. 2; registration and other publicity according to that law, art. 4) and gap-filling rules which refer merely to the "competent national law" (priority otherwise than in the case of goods for resale, bankruptcy and attachment, art. 7; preservation of privileges, art. 9).

During the Hague Conference on the Uniform Sales Law of 1951 only one delegate made a brief reference to the rules on reservation of ownership. He expressed the view that arts. 4 and 6 of the Draft required reconsideration but gave no reasons.

Gutzwiller in *Actes de la Conférence*, p. 230.

He also proposed reconsideration of the "conflict rules" in arts. 7 and 9 (in truth the gap-filling rules) in the light of the planned conventions on private international law relating to sales and the transfer of ownership.

Gutzwiller, *ibid.*, p. 234.

In its resolutions the Conference took up the latter point.

Résolution IX (d), *Actes de la Conférence*, p. 277.

The Special Committee appointed by the Hague Conference for the revision of the Draft does not seem to have discussed the rules on reservation of ownership.

No reference is to be found in the mimeographed records of the five sessions held from 1952 to 1955.

But the Draft which emerged from these deliberations omits any rules on reservation of ownership, without a word of explanation. The most likely reason for the tacit removal of the provisions is the deletion, from the Draft, of uniform rules on the transfer of ownership because this topic apparently proved too difficult for uniform solution. Moreover, the Draft was intentionally limited to rules governing the relations between seller and buyer.

Commission spéciale nommée par la Conférence de la Haye sur la vente, *Projet d'une loi uniforme sur la vente internationale des objets mobiliers corporels* (1956) p. 29.

2.6.1.3 *The draft EEC-Bankruptcy Convention of 1970*

The most recent attempt at a uniform regulation of certain questions of clauses reserving ownership in the seller can be found in the draft bankruptcy convention elaborated by the six original member countries of the European Communities in 1970. Any attempt to harmonize the bankruptcy laws of the member countries must of necessity grapple with the widely diverging effect which the frequently used clauses reserving ownership have under the national laws in the event of buyer's bankruptcy.

The Draft of 1970 provides in art. 39, para. 1 that the effect of a reservation of ownership in the *buyer's* bankruptcy shall be governed, in general, by the law of the country where bankruptcy has been adjudicated. However, the sentences which follow prescribe two minimum requirements which that legal system (i.e. the national law of each member country) must fulfil. As to its form, the reservation of ownership relating to the good sold and securing the purchase price, is to be valid as against the creditors of the buyer if expressed in a simple writing issued before delivery. This writing is not to be subject to any formality. At the same time, the trustee in bankruptcy is given the right to prove by any means that the writing or its date are fraudulent or wrong. These rules are a compromise between the complete disregard of reservations of ownership in the buyer's bankruptcy according to Belgian, French and Luxembourg law on the one hand, and their very liberal admission (including all manners of extension) in Germany, on the other hand. It is quite possible that such a median line may also be acceptable on a broader international level.

As to the effect of the *seller's* bankruptcy, art. 39, para. 2 refers to Appendix I, art. 6. According to this latter provision, the seller's bankruptcy, if adjudicated after delivery of the goods sold, may not be used as a justification for rescinding the sales contract, corresponding to the trustee's right of rescission in the buyer's bankruptcy (*supra* 2.3.5.1 sub (*b*)). It shall likewise be no obstacle to the buyer's acquisition of ownership in the goods sold.

2.6.1.4 *ECE General Conditions*

A very limited unification may also be seen in a standard clause to be found in several General Conditions elaborated by the United Nations Economic Commission for Europe. The clause contains three rules.

The first rule provides that in the case of delivery before payment of the contract price in full plant and machinery shall, until payment, remain the property of the seller, to the extent permitted by the law of the country where the goods are situated following delivery.

Secondly, if this law does not permit such reservation of ownership, the seller is entitled to the benefit of such other rights as that law permits him to retain. And thirdly, the buyer is to give the seller every assistance in taking any measures required to protect the seller's right of ownership or such other right.

ECE General Conditions for the Supply of Plant and Machin-

ery for Export (no. 188 of 1953) no. 8.3; *idem* (no. 574 of 1955), no. 8.3; ECE General Conditions for the Supply and Erection of Plant and Machinery for Import and Export (no. 188 A of 1957), no. 11.3; *idem* (no. 574 A of 1957), no. 11.3.

Zweigert/Kropholler, *Sources of International Uniform Law I* (1971) E 150 (pp. 90, 98, 120, 127).

Although the use of these conditions in international transactions is not infrequent, it should be stressed that their unifying effect is very limited. This is primarily due to the fact that the General Conditions, if agreed upon by the parties, constitute nothing but an agreement between seller and buyer, not binding upon third persons. Moreover, the clause is couched in such general terms that its content is relatively vague.

2.6.1.5 *Conclusion*

From the foregoing survey we must conclude that up to the present time no legislative rules are in force effectively unifying the divergent national rules on security interests. The only draft provisions with any prospect of becoming effective in the foreseeable future are those of the draft Bankruptcy Convention of the member States of the European Communities (1970). However, these are confined to a few aspects of reservation of ownership and do not even cover cases of attachment.

2.6.2 *Recent proposals*

Two proposals for unification of certain security interests in movables which have recently been submitted in Europe deserve particular attention. These proposals were made in two studies submitted to the Council of Europe, one in 1968 by UNIDROIT, the other in 1972 by the Service de recherches juridiques comparatives of the CNRS of Paris (referred to as French study).

2.6.2.1 *Need for unification*

For the areas in which the French study recommends unification efforts, it unfortunately does not deal with the question why such unification is necessary. Although from the context it is reasonably clear that such need is impliedly affirmed, no reasons are given to explicate this need.

The UNIDROIT study is more explicit on this point. With respect to rights securing to a seller the purchase price instalments, harmonization or unification of the various national security interests is not deemed necessary at present. This conclusion is based on the observation that in the absence of a single economic market in Europe, instalment sales necessarily remain local phenomena, circumscribed by the frontiers of a national economy. The absence of any element of internationality obviates the necessity for harmonization (p. 49).

A very similar line of thought is developed for the credit sale of motor vehicles. Here, local sales also prevail, largely for practical reasons, such as repairs, avoidance of customs problems, the attraction, if not necessity, of local servicing etc. It is foreseen that even after attaining a single European market, most of these practical difficulties will remain, so that "international sales of motor vehicles on credit will remain exceptional, if not a purely theoretical exercise" (p. 220).

Similar statement p. 235. However, harmonization or unification is recommended in the case of the realization of a common market. The Commission of the European Communities has recently confirmed that in the Common Market sales of used vehicles over the border of the member countries are rare because of many obstacles with respect to taxes and insurance (Reply of 22 Oct. 1974, *Official Journal of the European Communities* 1974 no. C 145, p. 1).

However, contrary to instalment sales in general, the credit sale of motor vehicles may subsequently obtain international aspects, even though the sale is local in its initiation. This subsequent internationalization may occur if the buyer takes the car abroad and leaves it there or disposes of it or the car is attached by the buyer's creditors. UNIDROIT recognizes a need (although not yet pressing) for a certain unification in this area (pp. 226, 228, 232, 236).

Instalment sales which are subject to special legislation are practically consumer transactions and therefore without major interest for international trade. But even instalment sales of motor vehicles may present an international aspect and are therefore worthy of some action aiming at unification. In the wide and important field of international trade, credit transactions crossing the borders are very frequent and steadily increasing in number. For this reason we would endorse the implied conclusion of the French study and the explicit (although limited) recommendation of UNIDROIT: there is a certain need to harmonize the conflicting security interests.

2.6.2.2 *Methods of unification*

The French and the UNIDROIT study put forward proposals for unification on four different levels.

(*a*) The "maximum" solution of the French study would be the creation of a *uniform security interest for international cases.* As a substantive model it is suggested to adopt a slightly modified version of the *United States* Uniform Commercial Code article 9 since this would integrate the many existing varieties of national security interests. For purely national situations existing national law would be preserved (pp. 73-74).

It appears doubtful, however, whether the dichotomy between national and international situations on which this proposal is based can be applied usefully to security interests. This distinction has frequently been used in the past in order to delimit the scope of application of conventions seeking to unify certain types of contracts, especially for transportation, sales, etc. The criterion used to determine the international character of a contract has been either the diversity of the business residence of the contracting parties in different States, or the necessity of a border-crossing movement of goods or persons for the performance of the contract.

The UNIDROIT draft on uniform rules for sales with reservation of ownership of 1939/1951 (*supra* 2.6.1.2), by referring to the definition of international sales in the Uniform Sales Law (art. 1), would have combined the two criteria as alternatives.

It is true that the latter criterion particularly would also cover many security transactions with an international character, especially in connexion with import or export transactions (due to the border crossing of the goods charged). More doubtful is whether international loans (from a creditor in country A to a debtor in country B) if no transnational movement of the goods charged by the debtor is involved, should be brought under the uniform international régime. Although the loan itself has an international character, the securing of the loan does not and should therefore remain subject to the national régime of country B.

The decisive objection to the French proposal, however, is the fact that, unlike contracts, goods (especially durable goods) do not have a single economic function which may be considered to be of either national or international scope. Rather, goods serve different purposes in the hands of different holders. These different purposes may or may not imply border crossings in successive stages. Thus some goods may pass from the uniform international régime to a national régime, and perhaps vice-versa; such changes may occur repeatedly. Any change of the applicable system of law, particularly repeated changes, would pose very involved legal problems of information about, and recognition and adaptation of earlier security interests for which no answers seem to be available as yet; this will be shown *infra* 3.2.2. Therefore the elaboration of a uniform international régime of security interests for international cases, as distinct from existing national rules that would continue to govern purely national situations, is not advisable.

Even if this objection could be overcome, it is highly doubtful whether the nations of the world, in view of their widely differing national systems, would be able to agree upon a uniform solution. Even for the limited region of Western and Central Europe this possibility has been denied by two expert bodies.

UNIDROIT study p. 238-239; Fédération Bancaire de la Communauté Economique Européenne, Rapport 1966-1968, p. 49.

Such pessimism is even more apposite for unification on a worldwide level.

(*b*) The "next radical" solution proposed by the UNIDROIT study is the unification of the *conflict rules* on security interests. This would leave national systems largely unaffected.

Those aspects of the proposal which pertain to conflict of laws will be dealt with at the proper place (*infra* 3.2.3.2.1). The proposal relating to substantive law will be discussed *infra* 2.6.2.3.

(*c*) The "minimum" solution of the French study proposes an interesting method, namely the elaboration of a *contract-form* providing for the unilateral rescission of a contract of sale by the unpaid seller (pp. 74-75). This would come as close as possible to a reservation of ownership, although some very substantial differences remain. The decisive formal objection which must be dealt with here is the limited effect of such a contractual clause. To become effective, an express agreement between the parties to the sales contract is required. It is very doubtful whether a broad international unification can be achieved on this voluntary basis, even if it is promoted by the appropriate organizations.

(*d*) The UNIDROIT study suggests another possible step that would amount to the unification of just one (although admittedly a major) point: to establish for *motor vehicles an accompanying document* in which security interests would also be entered (pp. 239-242). This would be a kind of special portable system of registration. Although it is not clearly spelled out, it would seem that the implementation of this proposal requires an international convention, especially since the national documents should follow an "internationally recognized model" (p. 239), obviously in order to make them helpful for, and understandable to, foreign authorities.

The French study also briefly alludes to this idea, commenting that in view of certain national precedents, its general adoption in Europe would not seem to be too difficult to accomplish (pp. 56-57).

Without going into a substantive discussion at this point, we may conclude that it is doubtful whether the realization of even such a modest proposal is feasible. The first reason would be the very fact of its modesty: it could be difficult to justify introducing such a system only for motor vehicles. Admittedly, however, this is really a special kind of chattel characterized by a particularly high degree of mobility, including over frontiers. A growing number of court cases also shows that, indeed, practical problems on the international level have arisen.

A related doubt pertains to the question whether only a uniform document should be established or whether the legal régime for entries on the document should also be regulated. It would seem preferable to cover at least the major problems connected with entries, such as the effects on the *bona fides* of third persons. More doubtful is whether the problems of the international recognition of the security interests entered on the document can be solved at this time. This is a question of the conflict of laws that will be discussed later in another context (*infra* 3.2.2).

2.6.2.3 *Substance of the proposals*

Looking at the substance of the proposals we find three different suggestions.

(1) The most far-reaching idea is that put forward by the French study in suggesting the creation of a uniform security interest for international (as distinct from purely national) transactions. The model to be followed in substance is a slightly modified version of the *United States* Uniform Commercial Code article 9 (pp. 73-74).

It is difficult to comment on this proposal since the details of the deviations from the American model are not specified. The American régime may indeed be considered as the most modernized, rational and comprehensive system of security interests in the present world. It is true that the language of the Code would have to be denationalized and that a few provisions of the Code may require revision in favour of the debtor's unsecured creditors. In addition, the international character of the new security interest poses some new problems. First, a system of registration adapted to the special needs of international trade movements would have to be invented. Further, the very difficult problems of transition of a security interest from one of the existing national systems to the international system, and vice versa, would have to be solved; this latter issue would seem to be especially difficult. However, the most serious objection is the distinction between national and international security transactions, see *supra* 6.2.2.2.

(2) The UNIDROIT study offers two suggestions relating to publication of security interests:

(*a*) Extremely far-reaching, the proposal to create a uniform conflicts rule for security interests would also introduce a major innovation into many national laws. As a kind of minimum standard of publication and as the central connecting point for the suggested uniform conflicts rules, all contracting States would be obliged to establish a system of registration for security interests (p. 239).

This would mean a major change for all countries in which registration is not yet provided for (see *supra* 2.3.3.1, 2.3.3.2, 2.3.3.4). The objections against such a system of general registration for all security interests in any item have already been set forth (*supra* 2.3.3.6 sub (c)). They are reinforced if the emphasis in introducing such a system is placed upon the international aspects of security interests which, after all, play only a minor role at present. It is hardly conceivable that any national legislator would introduce an expensive, time-consuming, and complicated system of registration only for the purpose of providing the requisite connecting factor for international transactions.

(*b*) Much more modest is another suggestion of the UNIDROIT study, namely the introduction of an accompanying document for motor vehicles in which security interests would also be entered (pp. 239-242). This proposal would satisfy a genuine need because the number of conflicts relating to security interests in border-crossing motor vehicles is steadily increasing, especially in regions with very high mobility, such as Europe. The need appears to be particularly pressing with respect to lorries because these represent relatively major investments which not only serve to secure the seller's claim for the outstanding purchase price, but also serve as security for banker's credits to the enterprise. This limitation also guarantees the feasibility of the proposal since the number of lorries that are permitted to cross borders is relatively restricted. If the system worked well in this limited area, the next step might be to consider its expansion to include other types of or even all motor vehicles.

As mentioned earlier, not only the (uniform) document itself should be introduced, but also, the legal consequences of entries thereon should be fixed in a uniform way (*supra* 2.6.2.2 sub (d)).

However, two facts suggest some caution. The experiences with certificates of title in many states of the United States have shown the risks of fraud to which such certificates are exposed, especially falsifications and fraudulent procurement of duplicates. Experience in the United States has also demonstrated the difficult problems that arise from the coexistence of certificate-states and non-certificate-states within one economic unit. The latter difficulty can probably be overcome, while the former can be managed only in part since the human factors involved cannot be completely controlled.

(*c*) In this context another proposal not emanating from UNIDROIT should be mentioned. Economic circles in the European Communities have suggested the setting up of a central register of security interests, to be kept by the Council of Ministers of the Communities.

Fédération bancaire de la Communauté economique européenne, *Projet de Convention relative aux effets extraterritoriaux des sûretés mobilières sans dessaisissement* (without date).

Articles 6 to 12 of the proposed convention establish detailed rules for the creation and functioning of the Central Register. Article 7 deals with the application for registration and requires that the names of debtor and creditor, the encumbered goods and the claims to be secured be indicated. The conditions for terminating a registration are set out in art. 8; notable is the rule that the debtor may also obtain the creditor's consent by a judicial decision from a court outside the country of the creditor's residence or seat, provided that the decision is recognized in the creditor's country. The duration of the registration is limited to five years, but may be renewed on application for a like period; registration is automatically prolonged if at the expiration of the period the debtor is subject to bankruptcy proceedings or if an execution is pending against the encumbered goods (art. 9). Applications for registration or for its termination must be certified by a notary, a consul or a similar official (art. 10, para. 2). Any person may inspect the register and may ask for simple or certified copies of entries (art. 11).

This proposal for a central register of security interests constitutes an integral element of the suggested convention for extraterritorial recognition of security interests created in another member country of the European Communities. Its essential purpose is to overcome the necessity of reregistration upon removal of the encumbered goods to another country. The register would therefore merely supplement national registration systems where these exist.

A number of difficulties are connected with such a proposal. First, the practical importance of registration as a means of providing effective publicity to third persons would be considerably reduced by one centralized registration for a major part of Central and Western Europe. Secondly, an enormous concentration of bureaucracy would be necessary for this central register. Thirdly, since for purely local goods the national registration remains admissible and necessary, if required by the *lex rei sitae*, any interested person would have to consult two registers in order to clarify the legal status of goods. The proposal of a central register is therefore unconvincing even as regards a regional union.

(3) The French study suggests a contractual remedy to attain some of the effects of a reservation of ownership. Under the so-called consensual system of the French and many Latin legal systems, rescission of a contract (e.g., if payment of the remaining purchase price has fallen due) dissolves the contract of sale retroactively and retransfers ownership to the seller. It is suggested that such a rescission clause be inserted uniformly in sales contracts (pp. 74-75).

However, several objections must be raised against this idea. First, it is based on the French consensual system of transfer of ownership where transfer derives from the conclusion of the contract (or its rescission). However, many legal systems do not share this principle, but require for any transfer of ownership a transfer of possession. In these legal systems rescission by one party (or even if agreed by both parties) has no proprietary effects and therefore does not protect the seller. Second, even in French law a rescission declared after bankruptcy is not effective vis-à-vis the trustee in bankruptcy; therefore this remedy is useless in precisely the most dangerous situation.

In view of these major substantive objections to which an important formal objection must be added (*supra* 2.6.2.2 sub (c)), it does not seem worth while to pursue this proposal any further.

3. The international movement of goods subject to security interests

3.1 *Practical role of security interests in international trade*

3.1.1 *Present situation*

At present the conscious use in international trade and investment generally of security interests as a tool is not very frequent. This assertion is based upon the literature on export financing, a number of inquiries and interviews and appears to derive support from the relative dearth of judicial decisions affecting this subject.

Of course this does not imply that credit is not a feature of international trade. On the contrary, recourse to credit in international transactions is increasing constantly. However, such credit is often not secured by security interests in goods. In practice, numerous other arrangements or institutions either provide security or obviate its necessity. The more important of these are:

(1) The guaranteeing or insuring of export credits by specialized institutions in the exporter's home country. The security provided to the exporter by his national, state-supported institution is usually designed to secure repayment of the credit extended by the domestic seller or contractor to the foreign buyer. Institutional security for export credits is provided by almost all developed countries within the framework of general export promotion.

(2) Guarantees, especially by banks, to secure payment of indebtedness are widely used in international trade because they are a reliable, easily liquidated security.

(3) The necessity on the part of the seller to give credit is to some degree obviated by sales against documents and letters of credit.

The most important legal obstacle to the more frequent utilization of security interests in international trade would seem to be the fact that the validity and effect of a security interest in goods is everywhere subject to the law of the country of importation. Exporters are not infrequently ignorant of this rule; they either believe that their national rules automatically apply everywhere or think they can produce this result by including an (ineffective) contract clause declaring their national law to be applicable. Where the exporter or other creditor in an international transaction is aware of the above conflict rule, he is confronted with a vast variety of widely differing national rules on security interests which may have little or no similarity to rules with which he is familiar. Apart from the variation from place to place in the legal rules, a further drawback of this form of security is inherent in the very nature of goods. Even on a purely national level, resale or other liquidation of a security interest in goods after the debtor's insolvency is less profitable economically, more burdensome and more time-consuming than realization by recourse to proceeds of an insurance or other methods for safeguarding payment of purchase money itself.

In spite of all these disadvantages to which security interests are subject in international trade, the tendency to have recourse to them is growing. It would seem that two groups of creditors in particular use security interests in international transactions: firstly, international financing institutions, whenever they are obliged to accept such security located in the borrower's country, and secondly, exporters of plant and machinery who often attempt to obtain security interests in conformity with the law of the country of importation. The size and the duration of their trade credits often makes the trouble and the costs of the necessary arrangements worth while.

3.1.2 *Future trends*

A careful observer of the present scene of international trade may detect certain trends which enable a forecast of likely developments in the coming decade or two.

Since both the volume, and credit-demand in international trade is undoubtedly likely to increase, the need for security interests as a protective device will grow. This growth will be particularly noticeable within the various regional economic unions or compacts. Thus in the European Communities and in Europe generally the past years have produced an increasing number of cases in which the treatment of foreign-created security interests has been at issue.

The emphasis, as in the past, will be on security interests se-

curing the purchase price, either in favour directly of the seller or of a credit institution financing the seller (or buyer).

Less certain is whether in the foreseeable future national credit institutions will grant more credit outside their territorial border to debtors in other countries, with a consequent increase in the use of security interests in goods located abroad. One can merely say that such a development is possible. It would also imply that the status of foreign-created security interests, which generally secure loan-credit, may, in future, assume relevance.

Apart from intentionally created sale or loan arrangements in international trade, it is more certain that in an increasing number of instances originally national situations will, against the will of the secured creditor, turn into international ones. By virtue of the increasing international mobility of persons and goods it will happen more frequently than in the past that debtors will move into another country with their personal belongings and professional equipment. More often than not only the encumbered goods either in the debtor's possession or due to the debtor's disposition of the goods may cross frontiers, either temporarily or forever.

In the result, it can be said with confidence that the factual importance of security interests in international trade is likely to increase within the next 10 and 20 years.

3.2 *Security interests in goods* (excluding means of transport)

3.2.1 *Basic situations*

Two different factual situations may occur in practice which may call for a variation of the basic rules. One is the static situation which does not involve any movement of the encumbered goods over a frontier. The second is the dynamic situation where the encumbered goods will so move.

3.2.1.1 *The static situation*

Contractual security interests in goods are governed according to a long-established, almost universally recognized principle by the law of *situs* of the encumbered goods.

See Rabel, *The Conflict of Laws.* A Comparative Survey IV (1958) 60-64 with numerous references.

By the predominant view, the same rule is applied to statutory interests, including those of the unpaid seller guaranteeing the purchase price.

See Rabel *op. cit.*, IV 64-66.

The application of this basic rule to a static situation where the encumbered goods do not cross frontiers, does not, apart from minor doubts as regards statutory interests, cause difficulties.

Nevertheless, it is important to fix expressly this conflict rule. It guarantees that the security interests that have arisen in any country will, wherever their existence or effect may come to be litigated, be submitted to the same legal system. This is the highest degree of harmonization of law which can and needs to be achieved in this specific area.

3.2.1.2 *International removal of goods*

Problems only arise in the case of a *"conflict mobile"*, that is, on the encumbered goods crossing the territorial borders. Any such movement involves a conflict between the former and the new *lex situs*. Apportionment of "jurisdiction" between the two different *leges situs* seems on principle to be simple enough: the first *lex situs* governs all acts which have occurred while the encumbered goods were situated at the first location, whereas the second *lex situs* applies to all acts which have occurred at the second location.

But matters are complicated by the fact that the two *leges situs* must be connected with each other. What is to be the fate of rights which have been created or have vested under the first *lex situs*? Should the law of the new location not give effect to them as far as possible? But such recognition of pre-existing security interests necessitates their transplantation into a new legal environment—a difficult operation in view of the very considerable divergencies in the various national legal systems.

The obstacles and limits to a transplantation of foreign-created security interests into domestic institutions constitute the nucleus of the legal problems involved in the international movement of goods subject to security interests.

3.2.2 *"Mobile conflicts"*

The French call conflicts between two or more successive *leges situs* arising from the international removal of goods a *"conflit mobile"*. We shall use an English version of the term as a convenient short-hand expression covering the various problems that arise in this factual situation.

From a legal standpoint the transplantation of a foreign security interest may take one of two forms: the foreign security interest may be preserved *"tel quel"*, or it may be adapted to a corresponding security interest of the new *lex situs*, i.e. domesticated. This second form of transplantation appears to be required by the general rule of the *lex rei sitae*, but is obviously a complicated process with which we shall be concerned in some detail (*infra* 3.2.2.1).

It has been asked whether a foreign security interest may not also be transplanted by adopting it *tel quel*, i.e. with the effects attached to it by the earlier *lex situs* or, more precisely, the *lex situs* of its creation. Such an exception seems indeed to be called for with respect to transient goods (*infra* 3.2.2.2).

The difficulties of any form of transplantation can, under certain circumstances, be, to some degree, avoided by creating a security interest according to the rules of a future *lex situs* (*infra* 3.2.2.3).

3.2.2.1 *Domestication of foreign security interests*

The international removal of encumbered goods has the consequence that the laws of the two (or more) locations successively claim application. Consequently, security interests created under the first *lex rei sitae* and still in existence at the time of the border-crossing must be domesticated at the new location in order to continue to exist under the new law governing them. Such domestication is certainly required if the goods can be expected to, or in fact remain for a more or less extended period of time in the jurisdiction of the new *situs*. If, on the contrary, they are intended to, or in fact, remain only provisionally, moving soon to a third country, or return to their original location, then a domestication of the foreign created security interests is possibly not necessary (*infra* 3.2.2.2).

The domestication of foreign security interests raises two separate questions. The first is to find in the new legal system an institution which is equivalent to the foreign created security interest. If such an institution has been found, the further problem concerns the method whereby the existing differences are to be bridged, i.e. to adapt the foreign to the corresponding domestic security interest. We shall discuss these two problems in turn.

3.2.2.1.1 *Equivalence*

A security interest created in country A can only be domesticated in country B if the latter has an equivalent device. Obviously, the domestication will be easier, in proportion to the extent the two institutions correspond to each other.

The only relevant legislative rule seems to exist in *Canada*. The (Uniform) Conditional Sales Act, adopted in most of the Anglophonic provinces, provides that a right of revendication or a preference for the price of the goods sold or a right to a dissolution of the sale and repossession of the goods granted to the seller under the law governing a contract of sale made outside the province, shall not be valid in the province after the goods are brought into it, unless the contract complies with the requirements of a conditional sales contract and is registered.

Canada: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 8.

The provision has obviously been drafted by the anglophone provinces in view of the French-inspired law of the province of Québec. By requiring unconditional domestication it reflects little effort on the part of the anglophone provinces to adjust

or accommodate to the special situation of Québec-created contractual and statutory security interests. At best this uncompromising attitude may be explained by the conviction that the Québec institutions mentioned above do not correspond closely enough to the anglophone conditional sale so that complete adaptation to the latter must be insisted upon.

A brief survey of court practice in a few countries shows how strongly the attitude of the courts in the receiving country is influenced by the forum's general approach to security interests. Thus the very liberal *German* system is reflected in the broad reception of foreign security interests.

Federal Republic of Germany: Federal Supreme Court 2 Feb. 1966, *BGHZ 45, 95, IPRspr. 1966/67 No. 54*: "Italian" reservation of ownership, although effective in Italy only as between seller and buyer given effect in Germany as a "German" reservation of title and therefore also against the German buyer's attachment creditors.

Federal Supreme Court 20 March 1963, *BGHZ 39, 173, IPRspr. 1962/63 No. 60*: "French" security interest in automobile in Germany valid as a non-possessory security interest against German attachment creditor of the French buyer.

OLG Hamburg 2 June 1965, *RabelsZ 32 (1968) 535, IPRspr. 1965/66 No. 73*: "English" reservation of the right of disposal equated to German reservation of ownership, but held invalid in Germany on other grounds.

Austrian courts have frequently had to deal with security interests created under German law. They have recognized them as far as their effects have complied with Austrian law. But effects of the "German" interests not compatible with Austrian law have been refuted, in general.

Austria: Supreme Court 19 Sept. 1956, *HS 1939-1958 part 2 No. 108*, and 7 June 1961, *SZ 34 No. 91*: "German" reservations of ownership ineffective in buyer's insolvency, as far as extension to products of the goods sold is concerned.

The status of a German fiduciary transfer of ownership as against attachment creditors of the debtor is controversial: it has been held valid (contrary to Austrian law) by Supreme Court 22 Sept. 1964, *ORiZ 1964*, 220; *contra* LG Innsbruck 2 June 1972, *Z.f.Rvgl. 1973*, 49.

In view of the very restrictive *French* attitude to security interests it is not surprising that foreign-created interests are also generally denied effect, if no efforts at "domestication" have been undertaken.

France: Trib.civ. Strasbourg 19 June 1957, *Rev.crit.d.i.p. 1959*, 95: "German" reservation of ownership invalid as against French buyer's attachment creditor.

Cour de Cassation 8 July 1969, Bull.civ. 1969 I 213, *Rev. crit.d.i.p. 1971*, 75: "German" security transfer of ownership invalid as against the debtor's attachment creditor.

Cour de Cassation 3 May 1973, Bull.civ. 1973 I 128, *Rev. crit.d.i.p. 1974*, 100: "Dutch" feigned security transfer of ownership invalid as against debtor's French attachment creditor.

But see Cour d'appel Amiens 10 Jan. 1974, *D.S. 1974 J. 363*: "German" reservation of ownership valid in French buyer's bankruptcy if unequivocally asserted by seller before adjudication in bankruptcy.

Legal writers have paid only scant attention to the specific problems and difficulties of domestication of foreign security interests, especially if the security interests of the new location do not precisely correspond to the former. Thus it has been correctly pointed out that in Belgium and France the true equivalent of a German reservation of ownership is not the local reservation of ownership—because it is ineffective in the buyer's bankruptcy—but (as far as industrial equipment is concerned) respectively the (reinforced) seller's privilege in Belgium and the Security interest under the French law of 1951.

Sauveplanne in an opinion submitted to the Commission of the EEC in 1963 (Doc. 8838/IV/63, p. 80); Schulze, note in *Rev.crit.d.i.p.* 1959, 98, 103.

However, if the necessary registration has not been effected, the seller will be restricted in the buyer's bankruptcy to the simple statutory seller's privilege.

Mezger, not in *Rev.crit.d.i.p.* 1974, 103, 107, 108.

From the foregoing cases and discussion the following conclusions may be drawn:

First, the chances of domesticating a foreign-created security interest depend a great deal on the spirit and structure of the substantive rules governing security interests at the new location of the encumbered goods. The more developed and liberal this law is, the easier the domestication of foreign security interests will be. Thus the all-embracing, uniform security interest of the *United States* (*supra* 2.1.3) should be particularly open in receiving any foreign security interest whatsoever. On the other hand, the widespread *French* spectrum of the varied, specific security interests (*supra* 2.3.2.3.1 sub (a)) will create considerable obstacles to the domestication of foreign security interests.

Secondly, the efforts that will have to be invested by the creditor (and the debtor) in order to domesticate a foreign security interest depend on the degree of conformity to the equivalent institution at the new location. If there is close conformity, as between reservations of ownership in the *Federal Republic of Germany* and *Austria*, the creditor will not need to do anything. In other instances, e.g. on removals to *France*, considerable efforts may be necessary in order to achieve domestication at an equivalent plane. If no efforts are made, the foreign security interest may lapse or may continue with limited effects, e.g. as a statutory privilege.

Thirdly, on a technical level domestication should achieve continuity between the foreign and the domestic security interest. Domestication is only the transformation of a pre-existing security which preserves its identity, although it may change its form and effects. Wherever the time of creation of a security interest is relevant (e.g. in the rules on fraudulent preferences), the original creation at the foreign *situs* should be relevant.

3.2.2.1.2 *Adaptation*

The necessity to adapt a foreign security interest to domestic requirements always exists if domestication is to be achieved, whether or not the former and the new interest closely conform to each other. Conformity looks only to the effects of a security interest. The effects, however, may depend upon the observation of certain formal requirements. Thus *German* and *Swiss* reservations of ownership conform closely in substance; and yet, many German reservations have lost their effect upon removal of the encumbered goods to Switzerland since the German creditors failed to register the reservation as prescribed by Swiss law.

If the new *lex rei sitae* establishes certain requirements, as, e.g., registration, for the continued existence of a security interest, they must also be observed for one created abroad. On the other hand, the new *lex rei sitae* may require certain formalities only for the act of creating the security interest (e.g., a notarial document, or attestation by two witnesses, etc.). Such formalities proper are subject to the universally accepted principle of *locus regit actum*. Therefore the law at the new *situs* does not insist that they be observed or repeated for a security interest created abroad.

Experience shows that the major practical problems in adapting a foreign created security interest to the conditions of existence established by the new *lex situs* are local requirements as to publication of the security interest, especially its registration. The difficulties engendered thereby are of two types.

The first is merely psychological. Many exporters, especially those in countries without a registration system, are ignorant of the necessity to file a registration and therefore stand to lose their security. Thus many German exporters who have had reserved ownership in their goods and have sold to Switzerland have lost their security interest due to the failure to register the latter, as required by Swiss law. Ignorance of the applicable

foreign law is, of course, not a problem which can be solved by legal means proper.

A genuinely legal problem is, however, posed by those legal systems which set up a maximum period for registration, usually calculated from the date on which the security interest has been created. The vast majority of these statutes do not anticipate or contemplate an importation of encumbered goods in future and do not thus provide a supplemental period for subsequent registration. Two remarkable exceptions are to be found in the *United States* and in *Canada*.

The *American* Uniform Commercial Code provides a grace period of four months after importation of encumbered goods within which the security interest, if it has been perfected before, must be perfected. If this is done, the security interest "continues perfected in this state".

United States: Uniform Commercial Code s. 9-103 (3) sent. 3.

If the security interest is "re-perfected" after the expiration of the four months period, perfection is not retroactive to the time of removal, but dates only from the time of perfection in the new state. The same is true if the security interest was not perfected under the former *lex situs* and is first perfected under the new *lex situs*.

Ibid., s. 9-103 (3) sent. 4 and 5.

This text has been preserved on the whole in the proposed 1972 version of the Code, with the following slight amendments. First, the grace period may be less than four months where the period of perfection in the former *lex situs* expires earlier, such lesser period being substituted. Secondly, the rules on the effect of a belated reperfection or on the first perfection of a hitherto imperfect interest have been repealed, probably as being unnecessary. Thirdly, if a security interest is not reperfected in time and therefore becomes unperfected at the end of the grace-period, it "is thereafter deemed to have been unperfected as against a person who became a purchaser after removal".

Uniform Commercial Code, 1972 version, s. 9-103 (1) (d).

These rather complex rules well illustrate the practical problems which are likely to arise in this field.

The *Canadian* provisions are simpler in pattern and have a slightly different approach. The grace-period for registration at the new location is determined on a different basis: the period begins to run after the secured creditor has received notice of the place to which the encumbered goods have been brought in the province and is then limited to 30 days (in a few provinces to 21 days).

(Uniform) Bills of Sale Act of 1928, revised 1955, amended 1959, s. 13; (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 7.

This rule is, of course, much more "creditor-inclined" and therefore harsher against third persons resident in the new location. It may be years before the creditor receives information on the new location of his goods, and yet he is protected throughout this time. It is not entirely certain, although probable, that the foreign-created security interest remains valid during the 30 days grace-period. If no new registration takes place within the grace-period, the statutes enunciate the persons against whom the security can no longer be set up; these are a creditor of the debtor and a purchaser in good faith for valuable consideration and without notice.

See the provisions cited.

These persons are the same as against whom a purely domestic security interest is invalid, unless registered.

See (Uniform) Bills of Sale Act s. 4 (1) and (Uniform) Conditional Sales Act s. 3.

Thus, in effect, perfection in the American sense is intended.

Similar grace-periods should be made available for all means of publication, not only for all systems of registration, but also for the requirements of a formal contract or marking of the encumbered goods (*supra* 2.3.3.4). One way of overcoming the difficulties of reregistration as the major obstacle to complying with the conditions of the new *lex situs* would be to substitute for, or supplement, the various national registration systems with an international register. This course is feasible, if at all, only on a regional basis. Indeed, it has been recently proposed by economic circles for the European Communities (*supra* 2.6.2.3 sub (2) (c)).

These formal requirements apart, if there is no close conformity between the security interest of the old and the new location, the parties may have to transform the interest originally agreed upon. Thus upon importation of goods to *France* in which a foreign seller has reserved ownership, it will be desirable to transform these reservations of ownership into one of the available special security interests (*supra* 2.3.2.3.1 sub (a)). The parties will have to draw a new contract and to procure its registration.

The initiative for an adaptation to formal requirements for the continued existence of a security interest or a substantive transformation to a new form of device must always be taken by the secured creditor. But in many instances, and especially in the case of substantive transformation, the debtor's cooperation may be necessary. Perhaps the duty to co-operate can be implied from the original contract between the parties. Especially where the contract envisages movement of the encumbered goods across frontiers, the debtor must be held bound to co-operate in every act that may be necessary to create an equivalent security interest at the new location of the encumbered goods. But it would be preferable to establish this obligation expressly in order to exclude doubts and uncertainty.

3.2.2.2 *Exception: transient goods*

The difficult process of domesticating foreign security interests is certainly called for where an international removal of goods is more or less "definite". But it is very doubtful whether domestication is also necessary in the very frequent instances where encumbered goods merely pass through one or several foreign countries and soon return to their home country. Thousands of automobiles cross daily the frontiers of European countries in which reservations or security transfers of ownership exist or which are subject to hire-purchase; the same applies to more valuable equipment carried in lorries or by tourists. It would be absurd to think that in each of these cases complicated adaptations to the new transient location (perhaps, where applicable, with registrations as in France or Italy, see *supra* 2.5.1.4) would be necessary. This would be the end of international tourist or freight traffic. Clearly, the security interests created at the permanent location of these goods continue to exist *tel quel* during these voyages. This assertion is not put to any test as long as these goods do not come in touch with the legal system of the transit country, i.e. as long as no person asserts rights in the goods that are based on the legal system of the transit country. It may be assumed that this is true in more than 99 per cent of the cases.

Similarly apparently Goode and Ziegel 220.

More doubtful is the situation where the goods become subject to some transaction or act of execution in the transit country (e.g., the encumbered goods are stolen or sold or a local creditor exercises a statutory privilege on them or brings execution). In such cases it may seem indispensable to adapt the foreign security interest to one of the categories at its present location. However, this conclusion is not cogent because its consequences may be far-reaching. Thus foreign-created security interests would have to be registered if the new location demands registration; and if no special time-limit should be provided for imported security interests, these would always be ineffective at the new *situs*.

It would seem appropriate that the security interests encumbering transient goods which, by some legal act, have become affected by the law of a transit country should remain subject to the law of the permanent location at which they have been created, unless and until their permanent location is moved to another country. On the other hand, the legal effect of any act affecting the security interest in the transit country must be

governed by the law of this *situs*. A partial precedent for this general approach is to be found in a decision of the Supreme Court of the Federal Republic of Germany. It recognized a security interest created in France in a French lorry according to the decree of 1953 when the lorry was attached in Germany by a German creditor. The court did not attempt to transplant the French security interest into one of the German categories, but recognized it as supporting a claim for preferred satisfaction by the French creditor, presumably by virtue of French substantive law, but asserted according to the procedural rules of the *lex fori*.

Federal Supreme Court 20 March 1963, *BGHZ 39, 173, IPRspr. 1962/63 no. 60*. The decision has been supported unanimously by German writers.

The attachment by the local creditor, on the other hand, was certainly subject to the *lex fori*, both as to substance and as to procedure.

The rule outlined above is, however, not yet generally accepted.

A related exception concerns "res in transitu"; this refers mainly to goods sold for export which on their way to the import country may pass through various other countries. Here again it would be inappropriate to assume that each transit country impregnates the legal status of any security interest created in the country of exportation, unless the goods come into legal contact with a transit country. Opinions of writers are sharply divided,

see Rabel, *Conflict of Laws IV (1958)* 101,

but the problem seems to have little practical relevance, as is shown by the dearth of judicial decisions.

3.2.2.3 *Creation of security interest according to a future* lex situs

The major difficulties of adapting a security interest to a new *lex situs* would be avoided if it were possible to create a security interest according to the law of the country of importation while the encumbered goods are still in the country of exportation. This method avoids any attempt at complying with the rules of the first location of the goods because security is not needed there, but at the future location in the buyer's country. Therefore the difficulties of transforming a security interest from one legal system into another can be avoided.

Two examples of international business practice may be adduced. In one case General Electric sold television sets in New York to a Venezuelan firm under reservation of ownership. It was agreed that the sales contract was to be governed by New York law, the reservation of ownership by Venezuelan law. In the buyer's bankruptcy the American seller was allowed to reclaim the goods. The Venezuelan court held that the agreement between the parties submitting the reservation of ownership to Venezuelan law was valid on the ground (probably irrelevant) that the parties are free to select the applicable law. It further held that the certification of the parties' signature by a New York notary public complied with the requirements as to form of Law no. 491, art. 5 litt. (b).

See *supra* 2.3.3.2 sub (*b*). Decision of Juzgado Segundo de Primera Instancia en lo Mercantil (Distrito Federal) of 12 March 1970—unpublished.

In another case the Italian seller of certain machinery to be delivered to a German buyer in the Federal Republic of Germany had orally reserved ownership. According to Italian law such an agreement has no effect against third parties, but under German law is fully effective.

See *supra* 2.3.3.2 sub (*b*) and 2.3.3.1.

When the machines were attached in Germany by buyer's creditors, the Federal Supreme Court held the attachment to be invalid since the parties were deemed to have agreed upon a reservation of ownership under German law.

Federal Supreme Court 2 Feb. 1966, *BGHZ 45, 95, IPRspr. 1966/67 no. 54*.

The only statutory recognition of this practice is to be found in the *United States*. In derogation of the principle of the *lex rei sitae*, the validity of a security interest created abroad is governed by the law of the forum, subject to two conditions. First, the parties must have understood at the time of creating the security interest that the property would be kept in the forum state; and secondly, the encumbered goods must have been brought into this state within 30 days after creation of the security interest.

United States: Uniform Commercial Code s. 9-103 (3) sent. 2. The 1972 revision essentially maintains the rule, but with certain refinements:

(1) the provision is now limited to purchase money security interests (see *supra* 2.3.2.2);

(2) the rule is now bilateral, not unilateral as previously (when it was only for importations into the forum state);

(3) the law of the future *situs* is to govern only perfection (i.e. effects against third persons), not other aspects of validity;

(4) the 30 days period runs from receipt of the goods by the debtor; see s. 9-103 (1) (*c*).

An analysis of the case and statutory material reveals the following points. (1) As to the form of the conflicts rule, a bilateral rule is clearly better than a unilateral one. The latter covers only incoming property, whereas the former also extends to outgoing goods. Full security is, of course, only achieved if both countries affected by the transaction have a corresponding rule. (2) In countries without a special conflicts provision the basis of the rule is not derived from the party's autonomy, but the general *lex rei sitae*, although modified to the special circumstances of the situation. (3) The limitation to purchase money security interests appears to be justified. Goods encumbered for loans are usually not intended for international movement. (4) The new rule may pose the problem, as illustrated by the Venezuelan case, whether certain foreign public documents satisfy the provisions of the country of importation, if the latter's "perfection" depends upon such formalities rather than registration. (5) The practical effectiveness of this "forward-perfection" will mean that registration of incoming goods be made possible before the goods have entered the country of importation. (6) The status of third-party rights created in the goods before they leave the country of exportation is as yet uncertain. Perhaps considerations similar to those in the case of transient goods (*supra* 3.2.2.2) should apply.

3.2.2.4 *Obligation under the law of the exporting country*

In order to reduce the problems arising out of the existence in the buyer's country of mandatory rules as to the form of a contract which reserves ownership of goods sold, the *German Democratic Republic* requires the buyer to comply with such regulation in due time and to furnish proof to the seller of having done so.

German Democratic Republic: Gesetz über internationale Wirtschaftsverträge of 1976, art. 233 (2).

3.2.3 *Uniform conflicts rules*

One may usefully distinguish legislative attempts to achieve uniformity of conflicts rules from the more recent literary proposals for unification.

3.2.3.1 *Legislative unification of conflict rules*

The various attempts to unify conflicts rules relating to security interests, have met with little success so far.

3.2.3.1.1 *Bustamante Code of 1928*

According to article 111 of the Bustamante Code on Private International Law of 1928, pledged goods are deemed to be located at the place of the creditor's residence.

League of Nations, *Treaty Series*, vol. LXXXVI, p. 113. In force in 15 Latin American countries.

This rule is obviously based on the principle that a pledge requires transfer of possession to the creditor. In the title "Contracts", arts. 214-217 declare certain provisions relating to

pledges to be "territorial". This probably means that the law of the place of the creditor's residence applies.

Since the Code makes no reference to non-possessory security interests, it is hardly relevant for present-day purposes.

3.2.3.1.2 *Montevideo Treaty on International Commercial Terrestrial Law of 1940*

Four provisions of this treaty

United Nations (ed.), *Register of Texts of Conventions and other Instruments concerning International Trade Law* (1971), p. 254. In force in Argentina, Paraguay and Uruguay

deal with commercial "pledges". Article 20 subjects the contractual relations between creditors and debtors to the *lex situs* at the time of creation of the "pledge". Arts. 21 and 22 deal with international movement of the encumbered goods. In order to preserve rights acquired under the first *lex situs*, both the formal and the substantive requirements of the second *lex situs* must be observed (art. 21). Apparently rights acquired at the new location by bona fide third persons are governed by this law (art. 22, para. 1). These latter provisions correspond to the unwritten general conflicts rules set out above (see 3.2.1.2).

3.2.3.1.3 *Hague Convention on the Law Applicable to Transfer of Ownership of 1958*

This convention which is (as yet) not in force (and probably never will come into force) determines which law governs the transfer of ownership in international sales.

Conférence de la Haye de Droit International Privé, *Recueil des Conventions de la Haye* (1970), p. 16.

The convention therefore affects only reservations of ownership in international sales transactions. Art. 2 No. 4 of the convention provides that as between the parties the law governing the sales contract determines the validity of a reservation of ownership by the seller. As against the creditors of the buyer, any rights of the unpaid seller, such as a statutory privilege or a claim for possession or ownership arising in particular by virtue of a reservation of ownership, are subject to the law of the place where the goods are situated at the time a claim is first asserted, or an attachment levied against the goods (art. 4, para. 1). This rule of the *lex rei sitae* is further made applicable to a sale by documents representing the goods; in this case the location of the documents rather than that of the goods is decisive (art. 4, para. 2).

These are the only rules applicable to one of the various types of non-possessory security interests. As regards their content, the remarkable feature of the rules is the form in which they adhere to the principle of *lex rei sitae*. By fixing as *situs* the place where the goods are located when a claim is first asserted, or an attachment levied against the goods, the Convention supports the thesis developed above with respect to the treatment of transient goods: by the assertion of a claim, or the levying of attachment against the goods, these clearly come into legal contact with the *lex situs* (*supra* 3.2.2.2). On the other hand, a *situs* without these contacts is not relevant under the Convention. At least for transient goods this restrictive interpretation of the *lex rei sitae* is very reasonable.

3.2.3.2 *Recent proposals*

Some of the more salient proposals put forward in recent years deserve discussion here.

3.2.3.2.1 *The draft of the "Fédération bancaire" of the European Economic Community (EEC)*

Apart from its proposals concerning single international filing (*supra* 2.6.2.3 sub (2) (c), the "Fédération bancaire" of the EEC has also elaborated certain conflicts rules for non-possessory security interests (excluding reservations of ownership).

Fédération bancaire de la Communauté economique européenne, *Projet de Convention relative aux effets extraterritoriaux des suretés mobilières sans désaisissement* (undated).

Under the draft, priority of the security interests as well as acquisition by third persons of the encumbered goods, is governed by the *lex situs* (art. 3, par. I and IV).

Uniform rules of substantive law determine priority *inter se* as between several security interests. They also provide that encumbered goods shall not become fixtures, and further contain provisions subrogating the secured creditor to his debtor's claim for the purchase-price where the latter has sold the goods to a *bona fide* third person (art. 3, para. II, III and VI).

A third category of rules specifies the equivalent rule in each domestic system applicable to security interests which, from the standpoint of that system, are foreign-created. As mentioned, article 3, paragraph I submits questions of priority to the *lex situs;* subparagraph 2 then proceeds specifically to name one particular type of security interest in each country, the priority rules of which are made applicable to any question of priority which may arise in that country in connexion with any category of foreign-created security interests. Article 4 makes similar provision for enforcement and insolvency procedures. This rule tacitly assumes that such procedures follow the law of the respective forum. If such a procedure affects a foreign-created security interest, the equivalent category of domestic security device is indicated, and its rules made applicable.

3.2.3.2.2 *Reservations as to utility of conflict rules*

The French study (p. 73) evinces great scepticism as to the utility of conflict rules. It points out that these work reasonably well between countries whose substantive laws are similar (as those of Austria and Germany). But conflict rules have proved inadequate in the case of countries whose internal laws differ considerably since in these cases the emergency clause of public policy is frequently invoked. It is therefore recommended that attention be directed primarily to a harmonization of the substantive law of the various countries.

This general conclusion does not take into account the possibility of unifying the conflict rules on security interests and therefore does not evaluate the possible utility of such unification.

Curiously enough, among the three possible solutions proposed for unifying the substantive law of security interests, the "median" solution is expressed as consisting of conflict of laws. The French study refers (p. 74) to the draft convention on bankruptcy of the member countries of the European Communities of 1970 which is said to provide, *inter alia*, for the mutual recognition of reservations of ownership (*supra* 2.6.1.3). As a matter of fact, the relevant provisions of the draft convention establish uniform rules of substantive law (see *supra* 2.6.1.3). The French study recommends the extension of the scope of such provisions beyond the field of bankruptcy.

3.3 *Security interests in automobiles*

Special conflicts rules for automobiles may be envisaged for two reasons. First, because vehicles are much more mobile than ordinary goods. And further, the official documents issued for automobiles and used, at any rate in some countries, for the registration or at least proof of security interests (*supra* 2.5.1.5), may assume relevance in the international movement of vehicles.

At present, no special rules affecting the truly international movement of automobiles seem to exist.

3.3.1 *United States*

Interesting special rules have been developed within the United States largely to regulate the heavy volume of interstate movements, although not restricted in law to these.

The Uniform Commercial Code at first had contented itself with one simple rule. If under the applicable provisions perfection of a security interest in goods covered by a certificate of title required indication thereof on the title, perfection of a security interest was to be governed by the law of the state which issued the certificate.

Uniform Commercial Code s. 9-103 (4).

This provision has turned out to be too simple because of its failure properly to take into account the difference between those American states which have certificates of title and those

which do not. More particularly, it failed to envisage the movement of automobiles from one category to the other. In the 1972 revision of the Code, a complicated new rule has been substituted.

The main rule has been preserved: the law of the state issuing the certificate governs perfection of security interests (s. 9-103 (2) (b)). Where the encumbered vehicle is moved, the former law remains applicable until either surrender of the certificate of title or new registration of the vehicle (s. 9-103 (2) (*b*). If vehicles are removed from a non-certificate state, the general rule affecting removal of encumbered goods is declared to be applicable.

Ibid., s. 9-103 (2) (*c*), see *supra* 3.2.2.1.2.

The rights of *bona fide* buyers are also strengthened. A buyer who does not trade in the respective kind of goods and who buys the vehicle and receives delivery of it without knowledge of the security interest, may have priority over a security interest created abroad. This is so if the security interest is not indicated in the certificate or if the certificate does not mention that the vehicle may be subject to security interests not shown on the certificate (s. 9-103 (2) (*d*)).

These new rules indicate adequately the problems that have to be anticipated by special conflicts rules relating to the international movement of automobiles.

3.3.2 *Proposals of the UNIDROIT study*

In its study, UNIDROIT recommends the adoption for automobiles of the system of international recognition of security interests as it has been established by international conventions for security interests in ships and aircraft. This would imply, according to the study (pp. 223, 239), the necessity of instituting a registration system for motor vehicles in each country, of harmonizing the rules on transfer of ownership and of introducing a single security interest. In the field of conflict of laws a uniform conflicts rule would have to be created under which the law of the place of registration would govern security interests in the vehicle. It is admitted, however, that court practice does not yet seem to have sensed a need to break away from the general rule of the *lex rei sitae* (p. 226).

We have recorded elsewhere our objections against instituting a special system of registration for the purpose of serving as a connecting point of a conflict rule (*supra* 2.6.2.3 sub (2) (*a*)).

However, this objection does not go to the substance of the proposed conflict rule. On the contrary, this rule in essence accords well with our own views on the legal status of transient goods (*supra* 3.2.2.2). The proposed conflict rule does not really depend on the existence of a registration system of the traditional nature in each country. "Registration" may be understood to relate to the administrative registration of motor vehicles—a procedure which probably exists everywhere. The same idea may also be expressed by referring to the law of the state which has issued the registration plate assigned to the vehicle.

Occasionally the UNIDROIT study also alludes to the "plate" as determining the applicable law (p. 223).

3.4 *Security interests in railway rolling stock*

No special conflicts rules appear to have evolved for railway rolling stock.

However, one rule indirectly affects security interests in these means of transport. Rolling stock of a railway as well as private wagons are exempted from attachment outside the home State.

International Convention Concerning the Carriage of Goods by Rail (CIM) of 1961, art. 56, para. 3; International Convention Concerning the Carriage of Passengers and Luggage by Rail (CIV) of 1961, art. 56, part 3 (Zweigert/Kropholler, *Sources of International Uniform Law II (1972)* p. 267, 316).

On a limited geographical scale recognition of foreign-created security interests is achieved within the member countries of the "Eurofima" (an "international" company for the joint financing and acquisition of railway rolling stock).

Convention of 20 Oct. 1955, United Nations, *Treaty Series*, vol. 378, p. 225.

According to article 3, lett. (a) "Eurofima" remains owner of the rolling stock financed by it until the full purchase price has been paid to it. This ownership will be recognized, by virtue of the convention, in all member States.

4. Recommendations

4.1 *Substance of the proposals*

Our specific proposals for a harmonization of the substantive rules relating to security interests as gathered from the preceding comparative analysis have been summarized in the conclusions appended to the various subdivisions of part 2. The detailed suggestions concerning the conflict rules governing security interests are contained in the analysis and discussion of part 3.

4.2 *Method of implementation*

The question to be discussed at this point concerns the best method for the implementation of the various proposals aimed at the improvement of the existing law. Three major methods appear to be available: a uniform law convention; a model law; and recommendations.

4.2.1 *Uniform law convention*

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.

4.2.2 *Model law*

An alternative to a uniform law convention would be a model law or perhaps on a lesser scale model rules. The distinctive difference lies in the fact that a model law does not impose upon contracting States the heavy obligation to introduce unified rules in their national legislation which would result from ratification of, or adherence to, an international convention. Another advantage may be that model rules are more easily adapted to the general framework of the national law. This consideration is particularly relevant in the case of model rules on security interests which will probably never aspire to cover all aspects of the field, but will merely supplement or amend a relatively limited number of existing national rules.

Of course, the informality and flexibility of the model law which may only require signature also threatens to undermine the success of such a measure. 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.

This last consideration stresses the desirability of enlisting the assistance of such institutions at an early stage in the process of elaborating model rules. This would also secure the expertise of financers with broad international experience and an outlook accustomed to steering a balanced course between the opposing interests of creditors and debtors.

4.2.3 *Recommendations*

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 sizeable number of States.

4.2.4 *Conclusion*

Our suggestion is therefore that the rules be framed in the

form of a model law, or model rules. In so doing the advice and assistance of the great international financial institutions should be sought, both for the elaboration and for propagation of such rules.

Appendices

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Decreto-Ley no. 6582 sobre régimen legal de los automotores of 30 April 1958 (*Código civil de la República Argentina y leyes complementarias*, Lajouane (ed.) 1969, 1010)

Decreto no. 9722 of 18 Aug. 1960 (*Ibid.*, 1019)

Ley de concursos no. 19 551 of 4 April 1972 (*El Derecho 42 (1972)* 1071)

Australia

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Liens on Crops and Wool and Stock Mortgages Act of 1898 (*New South Wales Statutes 1824-1957*, vol. VI, p. 302)

Queensland

Bills of Sale and other Instruments Act of 1955 (*Queensland Statutes 1954-1955*, p. 345)

Hire-Purchase Act 1959 (*Queensland Statutes 1959-1960*, p. 12)

Victoria

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Instruments Act of 1958 (*Victorian Statutes 1958*, vol. IV, p. 151), as amended by Instruments (Bills of Sale) Act 1958 (*Victoria Acts of the Parliament 1958* no. 6438)

Railways Act, 1958 (*Victorian Statutes 1958*, vol. VII, p. 429)

Western Australia

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Austria

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Canada

Railway Act (*Revised Statutes of Canada 1970*, ch. R-2)

(Uniform) Conditional Sales Act of 1928, revised 1955, 1959 (Conference of Commissioners on Uniformity of Legislation in Canada, *Model Acts Recommended from 1919 to 1961 inclusive, 1962*, p. 15). The Act or equivalent provisions have been adopted in nine out of 12 provinces (although with modifications)

(Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959 (*Ibid.*, p. 45). The Act has been adopted, partly with slight modifications, in six out of 12 provinces

Alberta

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British Columbia

Conditional Sales Act (*Statutes Brit. Col. 1961*, ch. 9)

Manitoba

Lien Notes Act (*Revised Statutes of Manitoba 1954*, ch. 144)

New Brunswick

Conditional Sales Act (*Revised Statutes of New Brunswick 1952*, ch. 34)

Ontario

Conditional Sales Act (*Revised Statutes of Ontario 1970*, ch. 76)

Saskatchewan

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Chile

Law no. 4702 on instalment sale of movables of 6 Dec. 1929 (*Código de comercio*, ed. oficial 1970, p. 419)

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Cyprus

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Denmark

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Dominican Republic

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Sale of Goods Act, 1893 (*Halsbury's Statutes of England vol. 22*, ed. 2, 1950, p. 985)

Finland

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Law of 24 Nov. 1950 (*Finlands Lag 1969* sub EK 97, p. 872)

France

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South Africa

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United States

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Interstate Commerce Act (United States Code title 49)

Uruguay

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Ley 8.292 of 24 Sept. 1928 on Prenda Industrial (*Ibid.*, p. 350)

Decreto containing regulations on the Law of industrial pledge of 29 Nov. 1928 (*Ibid.*, p. 352)

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Venezuela

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Regulations of the Corporación Venezolana de Fomento of 21 Aug. 1947 (*Ibid.*, p. 821)

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B. Note by the Secretariat on article 9 of the Uniform Commercial Code of the United States of America (A/CN.9/132)*

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INTRODUCTION

1. By way of introduction to the discussion of the item "Security interests" held at the eighth session of the Commission, the Secretariat gave an oral report on article 9 of the Uniform Commercial Code of the United States of America. Several representatives requested the Secretariat to make that report available in a document.[1] This document is submitted in response to that request.

2. The Uniform Commercial Code (UCC) is a uniform law governing certain aspects of commercial law. It has been adopted by 49 of the 50 states. There are nine major subdivisions entitled "articles". Article 9 governs security interests in personal property (movables). It does not govern security interests in real estate except to the extent that it governs the conflict in priorities between security interests in fixtures, i.e. personal property, such as a furnace, which becomes attached to the real estate, and security interests in the real estate itself.[2]

3. Prior to the adoption of article 9 there was a wide variety of security interests in personal property available in one or more of the 50 states.[3] This variety is illustrated by UCC section 9-102 (2) which provides that article 9 applies "to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, or other lien or title retention contract and lease or consignment intended as security".

4. Each form of security interest had its own rules in respect of the formal requisites for validity, the secured party's rights against the debtor and third parties, the debtor's rights against the secured party, and the filing or registration requirements. The existence of so many separate forms of security interest had the result that half a dozen filing or registration systems covering security interests in personal property might be maintained within a single state, some of which were maintained on a local basis and some on a state-wide basis, each of which had to be checked to determine a debtor's status.

5. Despite the large number of security interests, there remained gaps in the structure. In many states a security interest could not effectively be taken in inventory, although there was a real need for such financing. In those states in which inventory financing was possible, it was often baffling as to how to maintain a technically valid security interest when financing a manufacturing process, where the property subject to the security interest, i.e. the "collateral", starts out as raw materials, becomes semi-finished goods and ends as finished goods.

6. This bewildering variety of security interests and

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* 28 February 1977.

[1] *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17* (A/10017), para. 62 (Yearbook ..., 1975, part one, II, A).

[2] Sect. 9-313. See paras. 63-67, below.

[3] "State" law means the law of one of the 50 states. The law of the national Government is usually referred to as "federal" law.

legal rules greatly hindered the extension of credit on a national basis. On the insolvency of the debtor many creditors found that their security interests were unenforceable because they had not been created or perfected in accordance with the law of the state in which enforcement was sought.[4] Other creditors who were aware of the requirements of the local law found that the costs of adjusting their financing techniques to the exigencies of so many different systems of security interests greatly increased the cost of secured credit.

7. Article 9 was conceived and drafted to overcome these difficulties. Its purposes were:

To modernize the law of security interests;

To create a unified and coherent system of security interests within the state of enactment; and

To unify the law of security interests among the states and other political units of the United States.

There is general agreement in commercial and legal circles in the United States that it has solved these problems well. This is so even though complete uniformity among the states has not been achieved because of the adoption by some states of non-uniform provisions.

8. The major factor which distinguishes article 9 from the prior law is that one unified set of provisions based on functional considerations covers all forms of security interests in all kinds of personal property used as collateral. In particular the differences in the pre-UCC law between the rights and obligations of the parties where the creditor had title to the collateral (e.g. conditional sales contracts) and the rights and obligations of the parties where the debtor had title to the collateral have been eliminated. In substitution there is a distinction between "purchase money security interests" and security interests which are not for purchase money.[5] Article 9 also overcame the difficulties of using as collateral inventory and money claims not represented by an instrument. Its provisions govern the secured financing of industrialist, merchant, farmer and consumer alike.[6] This unified law of security interests was achieved by creating a new conceptual scheme, a scheme which often uses old ideas expressed in new language. Although the drafting of article 9 is detailed and has been said to be at times confusing, this conceptual scheme is not difficult.

9. Several versions of article 9 differing only in technical details have been promulgated. The discussion which follows is based on the current text, that of 1972.

Substantive provisions of article 9

Security agreement

Creation of security interests

10. Since article 9 covers only consensual security interests and not those interests created by operation of law, there must be an express contract for the security interest to arise.[7] This contract is called a "security agreement". There are few formal requirements for a security agreement to be valid and enforceable against the debtor and third parties.[8]

11. The security agreement can be oral if the "secured party" has possession of the collateral.[9] An oral security agreement made valid by possession is the article 9 version of the pre-UCC pledge.[10]

12. If the secured party does not have possession of the collateral, the agreement must be in writing and signed by the debtor.[11] Under the UCC such a signature may be made by a stamp or mechanical means as well as by hand.[12] The signature need not be notarized or otherwise authenticated.

13. A written security agreement must contain a description of the collateral.[13] The "description . . . is sufficient whether or not it is specific if it reasonably identifies what is described".[14] This rule rejects the earlier "serial number" test by which the description had to be specific. Therefore, a security agreement may use as general a description of the collateral as "all the inventory", if that indeed is an accurate description of the collateral. Nevertheless, the parties will normally specifically identify any collateral which can be so identified.

Other terms in the security agreement

14. In addition to these minimal requirements for validity, in practice most security agreements contain many clauses relevant to the contract between the parties. With few exceptions article 9 grants the parties complete freedom to fashion the security agreement as they wish so long as the provisions do not violate a general standard of good faith.[15]

15. There are two contract clauses, the validity of which were previously in doubt, which are specifically permitted: a "future advances" clause and an "after-acquired property" clause.

16. Under a future advances clause a current security interest is created in order to secure the repayment of money which the creditor agrees to lend to the debtor at some time in the future. There was a vaguely articulated prejudice against such clauses in the pre-UCC

[4] For the concept of "perfection", see paras. 21-42, below.

[5] For the concept of "purchase money" and the consequences for the parties which arise out of this concept, see paras. 49-53, below.

[6] In addition to article 9, there are a number of other laws which are relevant to consumer transactions involving security interests.

[7] However, certain limited security interests which arise under article 2 (Sales) and article 4 (Bank collections) are also included without the need of an express contract. Sect. 9-203 (1).

[8] In order to have "priority" against the rights of most third parties, the security interest must be "perfected". For a discussion of perfection and of priorities, see paras. 21-62, below.

[9] Sect. 9-203 (1).

[10] Possession also serves to "perfect" the security interest. See paras. 23-25, below.

[11] Sect. 9-203 (1) (*a*).

[12] Sect. 1-201 (39).

[13] Sect. 9-203 (1) (*a*). "[I]n addition, when the security interest covers crops growing or to be grown or timber to be cut, [the security agreement must contain] a description of the land concerned".

[14] Sect. 9-110.

[15] Sect. 1-208 limits the use of a term providing that one party may accelerate payment or performance or require additional collateral "at will" or "when he deems himself insecure". Sect. 9-501 (3) lists the rules dealing with procedure on default which cannot be waived or varied by the parties. No agreement which affects the priorities of third parties is binding on the third party absent his agreement. Cf. sect. 9-316.

The general obligation to act in good faith is found in sect. 1-203.

law. Although only a few states went to the length of systematically refusing to enforce such clauses, judicial limitations severely restricted the usefulness of such arrangements. A common limitation was that an interest claimed in collateral existing at the time the security transaction was entered into for advances made thereafter was good only to the extent that the original security agreement stated the specific amount of such later advances and even the times at which they should be made.

17. Such detail is often not known at the time of the agreement. The parties may desire to contract for a line of credit against which the debtor can draw in the future when and if he needs to. The parties may also wish to secure those future advances by a security interest in particular collateral. This could always be accomplished by executing separate security agreements each time money was paid out or credit was extended. Under such a system the priority arising out of each separate security agreement would depend on the date on which it was "perfected". Under article 9 a clause in the security agreement by which the named collateral secures advances to be made in the future by the secured party to the debtor is effective and, in general, priority will date from the time of perfection of the one security agreement.[16]

18. Similarly, prior to the enactment of article 9 there was a general prejudice against after-acquired property clauses in the security agreement, clauses by which the debtor created a security interest in goods to be acquired in the future. This prejudice was based on three major arguments. One argument was that it was logically impossible for a person to give a present interest in that which he did not own. Some courts were willing to recognize the after-acquired property clause as a promise of the debtor to create a security interest in the goods at the time the debtor acquired an interest in those goods, a promise which would be specifically enforced by the courts, but this theory caused certain problems under the bankruptcy laws.[17] The second argument was that debtors should be protected from their own tendency to overcommit themselves, creating security interests in goods which they anticipated receiving in the future. The third argument was that an after-acquired property clause was a means of defrauding other creditors of the debtor.

19. Whatever the value of these arguments in some contexts, they caused problems for those merchants whose major assets were either inventory or accounts receivable and who desired to use these assets to secure loans from banks or other financing institutions. In both cases the total value of the assets normally remained within constant limits but the individual units changed from day to day.

20. Because of the great business need in the United States for credit secured by inventory and accounts receivable, prior to the UCC a number of new security devices or practices were created to overcome the prejudice against after-acquired property clauses. Although these devices, which are now of historical interest only, took a number of different forms, they all had two elements in common. They were complicated and expensive. The enactment of article 9 which specifically authorizes the use of after-acquired property clauses has greatly reduced the complications and the cost.[18]

"PERFECTION" OF A SECURITY INTEREST

21. If the secured party does nothing more than enter into the security agreement with the debtor, his security interest is "unperfected". An unperfected security interest is completely valid and it is enforceable against the debtor and all third parties. However, it is subordinate to the rights of most third parties, including the trustee in bankruptcy.[19] Therefore, in case of the debtor's insolvency, the time when the security interest is of most importance, an unperfected security interest is of little practical significance. Conversely, the rights of third persons are generally subordinate to a "perfected" security interest.[20]

22. Depending on the type of collateral and transaction involved a security interest can be perfected in the following ways:[21]

Taking possession of the collateral;

Filing a "financing statement" in the appropriate government office;

Noting the security interest on a certificate of title;

Following the provisions of a statute or treaty of the United States, i.e. of the federal government, where one exists;

Becoming perfected automatically.

Perfection by possession

23. As was noted above, the security agreement need not be in writing if the secured party takes possession of the collateral. Similarly, possession of the collateral by the secured party constitutes perfection.[22] Therefore, the pre-UCC pledge is now a UCC security interest perfected by possession. It may be noted in passing that article 9 reproduces the prior law of pledge that the secured party must use reasonable care in the custody and preservation of collateral in his possession.[23]

24. The secured party has possession under article 9 from the moment the collateral is in his physical possession or in the physical possession of a third person who holds it for the secured party's account.[24] There is no "constructive" possession when the collateral is in the hands of the debtor.[25]

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[16] For the validity of a future advances clause, sect. 9-204 (3). For priorities in general, see paras. 43-62 and 66-67, below. The special problems of the priorities arising out of future advances clauses are handled by sects. 9-301 (4), 9-307 (3), 9-312 (3), (4) and (7).

[17] If the interest subsequently attached only at the time of bankruptcy, or at any time within 120 days prior to bankruptcy, it would constitute a voidable "preference" under sect. 60a (1) of the Bankruptcy Act. For this reason the "floating lien" theory used in some legal systems was not workable in the United States.

[18] Sect. 9-204 (1).

[19] Sect. 9-301 (1).

[20] The conflict between third parties and perfected security interests is considered in paras. 43-62 and 66-67, below.

[21] The means of perfecting a security interest are considered in sects. 9-302 to 9-305.

[22] Sect. 9-302 (1) (*a*), 9-305.

[23] Sect. 9-207.

[24] Sect. 9-305.

[25] See, however, the discussion of automatic perfection in paras. 39-42, below.

25. Possessory security interests are currently of commercial significance only in respect of negotiable instruments, investment securities,[26] negotiable bills of lading, negotiable warehouse receipts and other negotiable documents of title.[27] In each case possession of the piece of paper creates a security interest in the claim, the rights or the goods represented by that piece of paper.

Perfection by filing

26. The most common means of perfecting a security interest is by filing a financing statement with the appropriate government office. A security interest can be perfected by filing in respect of any collateral except money or instruments, which can be perfected only by possession, or those goods which special statutes require to be perfected by notation on a certificate of title or otherwise.[28]

27. In pre-UCC law it was common to perfect security interests, such as chattel mortgages or conditional sales agreements, by recording or filing the actual agreement or a full copy of it. This practice is not generally followed under article 9. Under article 9 the secured party files a financing statement.[29] "A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral."[30]

28. This abbreviated form of filing is known as notice filing. The financing statement gives notice to any person who may be interested that the debtor named therein may have created security interests in the types or items of collateral enumerated. The fact that there is a financing statement on file does not necessarily mean that there is a security interest in favour of the secured party named therein. It is possible that the financing statement was filed before a security agreement was made or conversely the obligation which was owed to the secured party may have been discharged without cancellation of the financing statement.

29. The value to the secured party of having a financing statement on file even though there is no current security agreement is that if, at any time in the future, a security agreement is completed between that secured party and that debtor in which the collateral falls within the types or items of collateral described in the financing statement, the security interest is perfected automatically on the completion of the security agreement. There is no gap, even of minutes, between creation of the security interest and establishment of its priority as against third persons. Moreover, a point which is even of more importance to the secured party, the priority of the perfection dates from the time of filing, not from the time the security interest was created.[31]

30. This system of notice filing is of particular importance where the same secured party periodically extends credit to the same debtor. One financing statement which describes the collateral as "inventory" would be sufficient to perfect a later series of individual security agreements in each of which some or all of the debtor's inventory was taken as collateral. The fact that the financing statement can be filed prior to the signing of the security agreement makes possible the negotiation of a line of credit to be drawn on in the future with the creditor confident that, to the extent of all advances of credit he has made, in the event of the debtor's insolvency, he will have priority over other creditors who have filed financing statements at a later time.[32]

31. It may be noted that the priority granted to any subsequently created security interest by virtue of the filed financing statement would seem to permit a debtor who faced insolvency to favour certain of his unsecured creditors over others by entering into security agreements with those creditors. Although article 9 itself contains no rule which would preclude such a result, none was considered necessary since the federal bankruptcy law has stringent provisions which strike down such a security interest for a pre-existing obligation entered into within 120 days prior to bankruptcy.

32. Although the system of notice filing permits broad descriptions in the financing statement, in the large number of cases in which the financing statement is intended to perfect a one-time loan or other advance of credit, the description of the collateral in the security agreement and in the financing statement are often specific and identical.

33. Article 9 does not take a firm position whether financing statements should be filed with local political subdivisions or on a centralized state-wide basis. Three alternative systems are "official" and some states have adopted variants of the three official systems.[33]

34. Both local and centralized filing systems have their advantages. Most credit inquiries about local business, farmers and consumers come from local sources; convenience is served by having the files locally available and there is little advantage in centralized filing for such debtors. On the other hand, centralized filing is preferable where the debtor has more than one location or place of business, any of which might be the place at which the financing statement might be filed under a local filing system. In recent years there has been a slow trend to centralize the filing systems.

35. The files are open to the public so that a prospective creditor can determine whether there is a financ-

[26] The most important kinds of "investment securities" are shares of stock in a corporation or bonds. For the technical definition, see sect. 9-102 (1) (*a*).

[27] "A warehouse receipt, bill of lading or other document of title is negotiable

(*a*) if by its terms the goods are to be delivered to bearer or to the order of a named person; or

(*b*) where recognized in overseas trade, if it runs to a named person or assigns."

Sect. 7-104 (1).

[28] Sect. 9-302 (1), 9-304 (1).

[29] Sect. 9-402. "A copy of the security agreement is sufficient as a financing statement if it contains [the information required for a financing statement] and is signed by the debtor." Sect. 9-402 (1). In order to discourage the filing of security agreements as financing statements, many states charge a higher filing fee if the financing statement is not of a standard size of 5 by 7 inches (127 by 178 mm).

[30] Sect. 9-402 (1).

[31] Sect. 9-312 (5) (*a*).

[32] Subject to the rights of purchase money secured parties. See the discussion at paras. 49-56, below.

[33] Sect. 9-401 (2).

ing statement currently on file. The difficulty of searching files at a distance has been reduced by the provision which requires the filing officer on request (and the payment of a fee) to issue a certificate showing whether there is on file on the date and hour stated therein any presently effective financing statement naming a particular debtor and, if there is, giving the date and hour of filing of each such statement and the names and addresses of each secured party.[34] In addition, in some states the filing officers will answer telephonic inquiries, although this is not required by article 9. There are also commercial organizations which will search the files for a client.

36. A filed financing statement is effective for a period of five years from the date of filing at which time it lapses.[35] Continuation statements can be filed to extend the effectiveness of the original statement.[36] There is no limit to the number of continuation statements which can be filed. If a continuation statement is filed prior to the lapse of the original financing statement, the date of priority is determined by the date of filing of the original financing statement.

Certificate of title

37. In most states, once motor vehicles and the like are sold for use, they must have a certificate of title on which can be noted any security interests in the vehicle. In those states in which such a requirement exists, the notation constitutes perfection.[37] For all other purposes the security interest in the motor vehicle is governed by article 9.

Statutes and treaties of the United States

38. The federal government has by statute or treaty created special régimes for security interests in particular kinds of goods in which there is a special national or international interest. Some of these régimes are only for the recognition of security interests created in other countries,[38] some provide only for a means of perfection and leave other aspects of the law governing the security interest to the individual states,[39] while in a few cases a complete régime has been created.[40] In all these cases article 9, as state law, gives way to any conflicting provisions in the federal law.

Automatic perfection

39. There are a number of situations in which a security interest is considered perfected even though the collateral is in the possession of the debtor and no financing statement has been filed. In each case the total cost of perfecting, including the time of the personnel in filling out the forms and sending them to the appropriate office, was considered disproportionate to the loss of legal security suffered by third persons who may act in ignorance of the security interest. The most common situation envisaged is that in which the debtor has given a purchase money security interest in goods, other than motor vehicles or fixtures, which were purchased for his own personal, family or household purpose.[41] However, only two other situations, which are closely related to one another, are of commercial significance.[42]

40. To the extent that a securty interest in *negotiable* documents[43] arises for new value[44] given under a written security agreement, it is automatically perfected for a period of 21 days from the time it attaches.[45] This kind of interest can arise when a lender advances the funds necessary for the debtor to pay a draft which is accompanied by a negotiable document. Even if the lender does not take possession of the document, he can have a perfected security interest in the document for a period of 21 days. After this period of 21 days, the continuation of perfection would depend on filing a financing statement or taking possession of the document.[46]

41. Similarly, where the secured party has advanced funds and taken possession of a negotiable document as collateral, the document can be released to the debtor and the security interest will remain perfected for 21 days if the document is released in order for the debtor to sell or make necessary preliminary arrangements to dispose of the goods.[47]

42. In both these cases, which are sometimes referred to as "trust receipt transactions", the debtor needs possession of the negotiable documents for the purpose of reselling the goods, thereby raising the funds to reimburse the secured party, or for the purpose of "loading, unloading, sorting, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange".[48] Article 9, and the federal bankruptcy law, allow for the perfection to continue for 21 days even though the debtor has possession of the documents and there is no filing. However, anyone who purchases the documents or the goods represented by the documents

[34] Sect. 9-407 (2). For the procedure by which a potential lender of future credit can verify the current amount owed by the debtor and the specific items of property given by him as collateral, see sect. 9-208 and the official comments thereto.

[35] Sect. 9-403 (2).

[36] *Ibid.*

[37] Sect. 9-302 (3) (*b*). Motor vehicles held as inventory by a used or new car dealer are subject to the normal system of perfection by filing a financing statement.

[38] E.g., Convention on the International Recognition of Rights in Aircraft, Geneva, 19 June 1948, 310 UNTS 151.

[39] E.g., 49 USCA sec. 20c (railroad rolling stock); 49 USCA sec. 1403 (aircraft).

[40] E.g., 46 USCA secs. 911-984 (Federal Ship Mortgage Act).

[41] Although a purchase money security interest in goods, other than motor vehicles or fixtures which were purchased for his own personal, family or household purposes is automatically perfected and will have priority against other creditors and in bankruptcy, a buyer of the collateral will take free of the security interest, even though it was perfected, "if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods". Sect. 9-307 (2).

The concept of a "purchase money security interest" is discussed more fully at paras. 49-56 below.

[42] The list of security interests which are automatically perfected with neither a filing nor possession is given in sect. 9-302 (1) (*b*), (*c*), (*d*), (*e*), (*f*) and (*g*).

[43] For the concept of a negotiable document, see note 27 above.

[44] "New value" is not defined but in general it is to be distinguished from "old value", i.e. antecedent debt. See sect. 9-108, official comment No. 2.

[45] Sect. 9-304 (4).

[46] Sect. 9-304 (6).

[47] Sect. 9-304 (5).

[48] *Ibid.*

from the debtor in good faith has priority over the secured party in the documents or the goods.[49] In other words, such a perfected security interest is of value in case of conflict with other creditors but not in case of conflict with a good faith purchaser.[50]

PRIORITIES

43. A secured party will wish to perfect his security interest in order to establish his priority against third parties in the distribution of the debtor's assets in case of the debtor's insolvency. The security party may need to assert his security interest in particular collateral against four major classes of third parties:

Holders of liens which are not security interests;

other secured parties;

Purchasers of the collateral;

Trustee in bankruptcy.

Holders of liens

44. In general, liens arising by operation of law or through the execution of a judgement or the like have priority over all security interests which are unperfected at the time the lien is created.[51] Conversely, perfected security interests have priority over all liens created subsequent to the date of perfection.

45. The one major exception to this rule is that if the lien is possessory and it arose from the furnishing of services or materials with respect to goods subject to a security interest in the ordinary course of the lien holder's business, the lien normally has priority over a perfected security interest.[52] The most common situation in which such a possessory lien arises is when an automobile or other goods subject to a perfected security interest is taken to a dealer for repair. The dealer has a possessory lien for the value of the repairs done to the automobile. This possessory lien would normally take priority over the prior perfected security interest in the automobile. However, if the dealer returned the automobile to the debtor, he would lose his possessory lien and therefore his priority.

Other secured parties

46. In a contest for priority between two unperfected security interests in the same collateral, the first security interest to have attached to the goods prevails.[53]

47. In a contest for priority between a perfected and an unperfected security interest, the perfected security interest prevails even though it was created later in time and even though at the time of creation or perfection the perfected secured party knew of the earlier created unperfected security interest.[54]

48. In general, in a contest for priority between two perfected security interests, the first security interest to have been perfected prevails.[55]

49. The major exception to this latter rule arises when the subsequent security interest is a "purchase money security interest". A security interest is a purchase money security interest if either: (i) the seller of the collateral has taken or retained a security interest in the collateral to secure all or a part of its price (similar to the pre-UCC conditional sale) or (ii) a bank or other financing institution has financed the acquisition of the collateral and has taken a security interest in the collateral to secure repayment.[56]

50. Unlike the situation under the pre-UCC law of conditional sales, the fact that a security interest is a purchase money security interest gives the secured party no rights against the debtor which other secured parties do not have. In particular, he may not retake "his" goods if the debtor is in default in repayment of the obligation unless the debtor does not object to such a retaking.[57]

51. However, a purchase money security interest can take priority over an earlier perfected security interest which is not a purchase money security interest if the proper procedure is followed.[58]

52. *Example*: A has a security interest in all D's equipment "now owned or to be acquired during the life of this security agreement" to secure a loan of $1,000. A's security agreement was perfected on 1 February. On 1 March D purchases a new machine tool for $10,000 from B. He pays B $1,000 cash and arranges to pay the remaining $9,000 over the next three years. To secure the $9,000 obligation, he gives B a security interest in the machine. Although A has a perfected security interest in the machine tool by virtue of the pre-existing after-acquired property clause, the priority of which dates from 1 February, B has priority over A by virtue of his purchase money security interest if he perfects his security interest by the time D receives possession of the machine or within 10 days thereafter.[59]

53. If the purchase money security interest is with respect to inventory, the purchase money secured party must give notification in writing to any person who has filed a financing statement with respect to inventory in order to have priority over that person.[60] The reason for this special rule is that a secured party who has taken inventory as collateral expects there to be a turnover in the specific items of inventory with all new purchases to become part of the collateral in replacement of that which has been sold in the ordinary course of business. If this is not to be the case he should be so notified in time to protect his interests.

54. It should be noticed that where the security in-

[49] Sects. 9-307 (1) and 9-309.

[50] Even in the case of unauthorized sale, the secured party will have a continuing perfected security interest in the proceeds. See paras. 68-71, below.

[51] Sect. 9-301 (1) (*b*) and (3).

[52] Sect. 9-310.

[53] Sect. 9-312 (5) (*b*). As to the time when a security interest attaches, sect. 9-203 (2).

[54] Sect. 9-301 (1) (*a*).

[55] Sect. 9-312 (5) (*a*). In a technical sense this statement is not true where a financing statement has been filed prior to the making of the security agreement. As noted in para. 29 above, in such a case the date of priority is the date of filing, even though the security interest is not perfected until it comes into existence.

[56] Sect. 9-107.

[57] In fact, in one special case involving consumer goods the rights of the secured party to retain the collateral in satisfaction of the obligation are more restricted if the security interest is a purchase money security interest than if it is not. Compare para. (1) of sect. 9-505 with para. (2) of that section. See also para. 72, below.

[58] Sect. 9-312 (3) and (4).

[59] Sect. 9-312 (4).

[60] Sect. 9-312 (3).

terests have been perfected by filing, the rule giving priority to the first to file taken in conjunction with the notice filing system could lead to a situation where a debtor could find it difficult to use some of his goods as collateral for a loan.

55. *Example*: A files a financing statement on 1 February in anticipation of the lending of money to D in the future. The financing statement describes the collateral as "all inventory now owned or to be acquired". The anticipated loans are not made. On 1 July D goes to B to arrange to borrow money and offers to put up his inventory as collateral. B checks the financing statements on file under D's name and finds the statements filed by A. B knows that if A ever advances credit to D taking inventory as collateral; A will have priority over B even if B had previously advanced credit to D. In such a situation B may refuse to lend to D so long as there is the possibility that A could take priority over him by virtue of a later advance of funds.

56. Article 9 provides two means by which this result can be avoided. As described above, if B makes a purchase money advance to D and follows the prescribed procedure, he will have a priority over A. Secondly, section 9-404 allows the debtor (D) to require the secured party (A) to terminate the financing statement "whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value", as is the case in the example given.

Purchasers

57. The general rule is that purchasers of the collateral purchase it subject to the security interest.[61] This general rule is, however, subject to several important exceptions.

58. If the security interest is *unperfected*, any purchaser takes free of the security interest if "he gives value and receives delivery of the collateral without knowledge of the security interest".[62]

59. If a security interest in negotiable instruments or documents (or the two combined, which in article 9 terminology is called "chattel paper") is perfected by filing a financing statement, by the automatic perfection rules of section 9-304 (4) and (5)[63] or as proceeds under section 9-306 (2) and (3),[64] i.e. if the security interest is perfected in any manner other than by the secured party taking possession, a good faith purchaser of the instruments, documents or chattel paper takes free of the security interest.[65]

60. The most important exception to the general rule is that even if a security interest in inventory is perfected, a buyer in ordinary course of business (other than a purchaser of farm products from a farmer) takes free of the security interest even though the buyer knows of the security interest.[66] The reason for this rule is that it must be anticipated that inventory used as collateral will be sold in the ordinary course of business. The secured party's only legitimate interest is that, if the obligation is not to be paid immediately, he must be assured that his security interest will attach to the proceeds of the sale[67] and, if he so stipulates in his security agreement by an after-acquired property clause, to the replacement inventory.

Trustee in bankruptcy

61. Bankruptcy is governed by the law of the federal government. In case of conflict with the law of any state, including the Uniform Commercial Code, the federal bankruptcy law prevails.

62. When a person goes into bankruptcy, a "trustee in bankruptcy" is appointed to take control of the debtor's assets, to conduct the debtor's business operations if their continuation appears warranted, and to pay the creditors. In general the trustee in bankruptcy takes the debtor's assets subject to any prior *perfected* security interests. However, an unperfected security interest is of no value in bankruptcy and the unperfected secured party has the same status in the distribution of the bankrupt's assets as would an unsecured creditor.

FIXTURES

63. A special difficulty was encountered in reconciling the conflicts between a security interest in personal property and a security interest in the real estate to which that personal property becomes attached. The law in the United States governing rights in real estate is quite different from that governing rights in personal property and it differs markedly among the 50 states. In particular there is substantial disagreement as to the circumstances under which personal property becomes so attached to the real estate that it is subject to existing interests in the real estate even though it does not become part of the real estate, i.e. that it becomes a "fixture". In 1972 it was considered that, as a consequence of these difficulties, the earlier versions of section 9-313 on the priority of security interests in fixtures were inadequate and the text was substantially revised.

64. Even under the 1972 definition of a "fixture", i.e. goods which "become so related to particular real estate that an interest in them arises under real estate law" but which are not "ordinary building materials incorporated into an improvement on land",[68] the ultimate question of which goods are fixtures is left to the non-uniform provisions of the real estate law of each of the states. Goods which are in some manner related to particular real estate but which are not fixtures either (i) remain as ordinary goods, in which case the normal rules governing security interests in personal property are applicable, or (ii) become a part of the real estate in which case none of the rules governing security interests in personal property is applicable.

65. A security interest in fixtures is perfected by filing a financing statement containing all of the information required of any other financing statement plus "a description of the real estate".[69] The financing statement must be filed "in the office where a mortgage on the real estate would be filed or recorded",[70] which in some states would be the same office in which financing

[61] Sect. 9-306 (2).
[62] Sect. 9-301 (1) (*c*).
[63] See paras. 40-42, above.
[64] See paras. 68-71, below.
[65] Sects. 9-308 and 9-309.
[66] Sect. 9-307 (1).
[67] See para. 68, below.
[68] Sect. 9-313 (1) (*a*) and (2).
[69] Sect. 9-402 (5).
[70] Sect. 9-401 (1) and 9-313 (1) (*b*).

statements perfecting security interests in other personal property would be filed but in other states would not.

66. The two main rules in respect of priorities between a security interest in a fixture and an interest in the real estate are that, subject to certain technical requirements

> A security interest in fixtures, whether for purchase money or not, has priority over subsequent real estate interests only if a financing statement is filed before the subsequent real estate interest is of record;[71]
>
> A purchase money security interest in fixtures has priority over pre-existing real estate interests, including real estate mortgages and other security interests in the real estate, if a financing statement is filed either before or within 10 days after the goods become fixtures.[72]

67. The official comments to section 9-313 explain that the priority of purchase money security interests in fixtures over pre-existing real estate mortgages and other such interests, which was a change in the law in most of the United States, was intended to make available the "short-term credit necessary for the modernization of real estate by the installation of new fixtures [, such as furnaces, air-conditioning equipment and the like, which] in the long run could not [but] help real estate lenders".[73]

PROCEEDS

68. "Proceeds" includes whatever is received upon the sale, exchange or other disposition of collateral.[74] In some cases, such as inventory, sale is not only authorized by the secured party, it is desired, because it is only by such sale that the debtor can acquire the money to repay the debt owed. In other cases the disposition may be unauthorized or even involuntary, as in the case of the destruction of the collateral by fire where the insurance proceeds become "proceeds" under article 9.[75]

69. Whatever the nature of the disposition and whatever the nature of the proceeds which result, the general rule is that, unless otherwise agreed, a security agreement automatically gives the secured party a security interest in any identifiable proceeds.[76] Moreover, the general rule is that if the security interest in the original collateral was perfected, the security interest in the proceeds is also perfected.[77]

70. The security interest in the proceeds attaches to all proceeds which can still be identified. This is true whether the proceeds are other goods taken in exchange, accounts or notes receivable, checks which have not been deposited or cash which has not been commingled. Once the proceeds have taken the form of cash or of bank or other deposit accounts in which the proceeds have been commingled with other funds, a perfected security interest continues in the cash or deposit account limited to an amount not greater than the amount of any cash proceeds received by the debtor within 10 days before the institution of the insolvency proceedings less certain deductions.[78]

71. When the collateral disposed of is inventory, a continuing security interest in the proceeds and an after-acquired property clause by which incoming inventory is made subject to the security agreement serve much the same purpose. In both cases the total value of the collateral to secure repayment of the obligation owed to the secured party remains approximately the same even though the individual items change.

PROCEDURE ON DEBTOR'S DEFAULT

72. The procedure to be used on the debtor's default is designed to achieve the dual goal of assuring to the largest degree possible that the secured party will be paid the money owed him and that the debtor will suffer the least possible loss of property in the process. As one consequence of this policy, the secured party has lost the unilateral right he had under the typical pre-UCC conditional sales (i.e. title retention) statute to take and keep "his" goods. After default the secured party may propose to retain the collateral in full discharge of the obligation. However, if the debtor objects, as he would if the collateral could be sold for more than the outstanding claim, the collateral must be sold.[79] Moreover, any surplus from the sale of the collateral must be turned over to the debtor.[80]

73. Prior to the UCC the taking of possession of the collateral and the foreclosure sale were often the function of government officials, usually the sheriff. Experience showed that this was not the best system, either for the secured party or for the debtor. It was slow, it was administratively expensive, and the price received for the collateral was usually only a small fraction of its value. The debtor's right for a specified period of time to repurchase the collateral at the price paid at the foreclosure sale plus expenses was not a guarantee against a low sales price. In fact the existence of such a right of redemption lessened the value of the goods to the purchaser at the foreclosure sale, thereby causing the sales price to drop even lower.

74. Article 9 operates on the theory that on balance it is better for all parties if the foreclosure sale is as much like a commercial sale as possible. Therefore, "unless otherwise agreed a secured party has on default the right to take possession of the collateral . . . without judicial process if this can be done without breach of the peace or [the secured party] may proceed by [judicial] action".[81] Once the secured party has possession of the

[71] Sect. 9-313 (4) (*b*).

[72] Sect. 9-313 (4) (*a*). This rule does not apply where the conflicting real estate interest is a construction mortgage which was recorded before the goods became fixtures if the goods became fixtures before the completion of construction (sect. 9-313 (4) (*b*)).

[73] Sect. 9-313, official comment No. 8.

[74] Sect. 9-306 (1).

[75] This last point was not clear under the pre-1972 versions of article 9. Sect. 9-306 (1) now reads in part, "Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement".

[76] Sect. 9-306 (2).

[77] Sect. 9-306 (3). The statement in the text is subject to a number of technical, but important, exceptions which are set out in sect. 9-306 (3).

[78] Sect. 9-306 (4). Some question has been raised as to whether the provision will be enforced in bankruptcy proceedings, but the issue has not as yet been faced in a clear manner.

[79] Sect. 9-505. For a more restrictive rule where the security interest is a purchase money security interest in goods purchased for personal, family or household purposes, see sect. 9-505 (1).

[80] Sect. 9-504 (2).

[81] Sect. 9-503.

collateral after default he "may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing".[82]

75. "Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable."[83]

76. Experience with article 9 during the 10 to 20 years it has been in force has shown that when the debtor is himself a merchant, there is little reason to fear the potentialities for abuse by the secured party inherent in these default procedures. Merchant-debtors know the market for the collateral and they can either sell the collateral themselves at the best possible price and apply the proceeds to the obligation or they can advise the secured party of possibilities of sale. If the secured party does not follow such advice and receives a lower price for the collateral than he might otherwise have obtained, a court might later conclude that disposition was not effected "in a commercially reasonable manner".[84]

77. There are special rules within article 9 to protect consumer debtors who are less able to protect themselves against overreaching secured parties.[85] Moreover, in recent years there have been a number of new statutes and regulations, especially by the federal government, designed to protect consumers and some of these new rules affect default proceedings under article 9.

FOREIGN TRANSACTIONS

Recognition of foreign-created security interests

78. If a security interest is created in one state and the collateral is subsequently removed to a second state, the secured party will wish to enforce his security interest in the second state. Even within the United States prior to the widespread enactment of the UCC this caused serious problems because there were security devices in use in some states which did not have corresponding régimes in other states. At times the result was that the original security interest was lost if the collateral was removed from the state of origin with or without the consent of the secured party.

79. This is no longer the case under article 9. If a security interest was validly created under the provisions of article 9 in one state, there is no question but that it will be recognized as having been validly created under the identical provisions of article 9 in any other state to which the collateral may have been removed. Furthermore, it would be unusual for a security interest to have been validly created under the law of a foreign country but not to be valid according to the criteria of article 9, at least if the security agreement was in written form.[86]

80. The rights and obligations of the debtor and the secured party and the priorities between the secured party and third parties are those specified in article 9 in the state of enforcement rather than those specified under the law of the state where the security interest was created.[87] Security interests created in other states of the United States, except for Louisiana, are enforced as they were created now that all states other than Louisiana have enacted the UCC. Although security interests created in foreign countries are enforced under a régime different from the régime of creation, there is an assurance that the foreign-created security interest will be enforced. Moreover, since article 9 permits the parties to determine the majority of the provisions in the security agreement, the terms of the foreign-created security agreement would govern the transaction except as those provisions contravened the few specific prohibitions in article 9. However, the system of priorities may be different than it was in the country in which the security interest was created.

Perfection of foreign-created security interests

81. It would be possible to recognize the foreign act of perfection of the security interest to the same degree as is recognized the foreign act of creation. However, once the collateral has been brought to a second state, third parties who are interested in determining the status of those goods would look under the name of the debtor in the appropriate office in that state. They would not find the original financing statement there. On the other hand it would be excessively harsh on a secured party if the security interest was no longer perfected as soon as the collateral was removed from the state in which the security interest was originally perfected. No secured party can be expected to watch the collateral constantly to see that it has not been removed. Removal of the collateral is, of course, a more likely event between two states of the United States than it is between two countries.

82. Several different means have been used to overcome these difficulties. Long prior to the widespread enactment of the UCC some federal statutes were enacted providing for a nation-wide system of perfection for certain items of collateral of national or international interest.[88] Many, but not all, states require motor vehicles to have certificates of title on which all interests in the vehicle, including security interests, must be noted. So long as such a certificate of title is outstanding, the security interest noted thereon is perfected wherever the vehicle might go.

[82] Sect. 9-504 (1).

[83] Sect. 9-504 (3).

[84] "The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner." Sect. 9-507 (2).

[85] Sect. 9-505.

[86] That a valid security interest created in another state is to be enforced is clear from sect. 9-103. It is unclear whether a foreign-created security interest would be enforced under article 9 if it was not valid where created. But see sect. 1-105 on the parties' right to choose the law applicable to the security agreement.

[87] Although this result is nowhere specifically stated, it would be surprising if under sect. 1-105 any law were applied other than that of the state where tangible collateral is located at the time the default proceedings are begun.

[88] See para. 38, above.

83. For other collateral in which a security interest has been perfected in one state, article 9 provides that the perfection remains valid for four months after the collateral has been removed to a second state.[89] If within that four-month period of time the secured party reperfects by taking possession of the collateral or filing a financing statement in the second state, the perfection continues to be valid in that state and the priority dates from the original act of perfection in the first state.

84. *Example*: Secured Party perfects a security interest in machines by filing in state X on 1 February. On 1 March Debtor takes the machinery to state Y. (It is not important whether this happened with or without the consent of Secured Party.) The security interest will automatically continue to be perfected in state Y until 1 July. If Secured Party reperfects by filing a financing statement in state Y before 1 July, the date of priority in state Y is 1 February, the date of the original perfection in state X. If Secured Party reperfects in state Y on 15 July, i.e., after the expiration of the four-month period, the date of priority in state Y is 15 July.

85. This system of perfecting in two different states is not necessary if the collateral was purchased in state X with the understanding that it would be taken to state Y within 30 days. If the seller delivers the goods in state Y, there is, of course, no difficulty; since the buyer acquires his rights in the goods in state Y, the security interest attaches in state Y and it must be perfected in state Y. However, if the seller delivers the goods in state X and the buyer is to take them to state Y, the security interest in the goods must be perfected in state X as well as in state Y if the secured party is to be fully protected. In order to avoid the necessity of two filings in such a situation, article 9 provides that the secured party can file in the state to which the goods are intended to be taken, i.e. state Y, and for a period of 30 days the security interest is perfected in state X.[90] If the collateral remains in state X for more than 30 days, the security interest must be reperfected in state X for the perfection to continue without lapse.

86. *Example*: Goods are sold and delivered to Debtor in state X on 1 June with the understanding that they will be taken to state Y during the month of June. A security interest in the goods (normally for the unpaid balance of the price) is perfected in state Y on 1 June. The goods are taken to state Y on 20 June. During the period 1 to 30 June the security interest is perfected in state X, even though no act of perfection takes place in state X. The security interest is also perfected in state Y and the date of priority is 1 June.

[89] Sect. 9-103 (1) (*d*).

[90] Sect. 9-103 (1) (*c*).

III. INTERNATIONAL COMMERCIAL ARBITRATION

Note by the Secretary-General (A/CN.9/127)*

1. The Asian-African Legal Consultative Committee (AALCC),[1] at its seventeenth session held at Kuala Lumpur, Malaysia, 30 June-5 July 1976, considered the UNCITRAL Arbitration Rules that had been approved by the Commission at its ninth session.[2]

2. At the conclusion of its deliberations, the AALCC on 5 July 1976 adopted the decision concerning international commercial arbitration that is set forth as an annex to this note.

3. The Commission may wish to note that in paragraph 2 of its decision the AALCC commended the work of the Commission on the UNCITRAL Arbitration Rules and recommended their use in the settlement of disputes arising in the context of international commercial relations.

4. The Commission may wish to note further that in paragraph 3 of its decision the AALCC invited it to consider the possibility of drafting a Protocol to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. In order to assist the Commission in its consideration of paragraph 3 of the AALCC decision, the Secretariat has prepared document A/CN.9/127/Add.1** which analyses the specific proposals by the AALCC.

* 20 October 1976.

** Not reproduced in this volume.

[1] The following 32 States are members of the AALCC: Bangladesh, Egypt, Gambia, Ghana, India, Indonesia, Iran, Iraq, Japan, Jordan, Kenya, Democratic People's Republic of Korea, Republic of Korea, Kuwait, Libyan Arab Jamahiriya, Malaysia, Mauritius, Nepal, Nigeria, Oman, Pakistan, Philippines, Qatar, Sierra Leone, Singapore, Somalia, Sri Lanka, Syrian Arab Republic, Thailand, Turkey, United Republic of Tanzania, Yemen Arab Republic.

[2] See Report of the United Nations Commission on International Trade Law on the work of its ninth session, *Official Records of the General Assembly, Thirty-first Session, Supplement No. 17* (A/31/17), paras. 56-57 (Yearbook . . . , 1976, part one, II, A).

ANNEX

Decision by the Asian-African Legal Consultative Committee on international commercial arbitration

(Taken at its seventeenth session, Kuala Lumpur, 5 July 1976)

The Asian-African Legal Consultative Committee

1. Recommends to the States of the Asian-African region which have not ratified or acceded to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards to consider the possibility of ratification of or accession to the Convention;

2. Commends the United Nations Commission on International Trade Law for the successful conclusion of its work on the UNCITRAL Arbitration Rules and recommends the use of the UNCITRAL Arbitration Rules in the settlement of disputes arising in the context of international commercial relations;

3. Invites the United Nations Commission on International Trade Law to consider the possibility of preparing a protocol to be annexed to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards with a view to clarifying, *inter alia*, the following:

(*a*) Where the parties have adopted rules for the conduct of an arbitration between them, whether the rules are for *ad hoc* arbitration or for institutional arbitration, the arbitration proceedings should be conducted pursuant to those rules notwithstanding provisions to the contrary in municipal laws and the award rendered should be recognized and enforced by all Contracting States;

(*b*) Where an arbitral award has been rendered under procedures which operate unfairly against either party, the recognition and enforcement of the award should be refused;

(*c*) Where a governmental agency is a party to a commercial transaction in which it has entered into an arbitration agreement, it should not be able to invoke sovereign immunity in respect of an arbitration pursuant to that agreement.

IV. LIABILITY FOR DAMAGE CAUSED BY PRODUCTS INTENDED FOR OR INVOLVED IN INTERNATIONAL TRADE

A. Report of the Secretary-General: liability for damage caused by products intended for or involved in international trade (A/CN.9/133)*

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INTRODUCTION

1. The United Nations Commission on International Trade Law considered at its eighth session (1-17 April 1975) a report of the Secretary-General on "Liability for damage caused by products intended for or involved in international trade".** The Commission decided to continue work in respect of this subject and requested the Secretary-General "to prepare a further report for consideration by the Commission, if possible at its tenth session, that would examine, *inter alia*, the following issues:

(*a*) The extent to which the absence of unified rules on products liability affects international trade;

(*b*) The practicability and advantages of unification at a global level, as opposed to unification at a regional level;

(*c*) The relationship between this subject and schemes of insurance which have been or may be developed in relation thereto;

(*d*) The extent to which and the manner in which liability may be limited, and the possible effects of different techniques of limitation;

(*e*) The types of product in regard to which liability should be imposed;

(*f*) The classes of persons on whom liability may be imposed and the classes of persons in whose favour liability may be imposed, with particular reference to the protection of consumers;

* 12 April, 1977.

** A/CN.9/103. Yearbook . . . , 1975, part two, V.

(*g*) The kinds of damage for which compensation may be recoverable;

(*h*) The kinds of transaction falling within the scope of the proposed uniform rules;

(*i*) The relationship between any proposed uniform rules and standards of safety in relation to products which are mandatorily imposed in many States by national law".[1]

2. In addition, the Commission "was of the view that the Secretariat should also consider the advisability of circulating, at an appropriate time, a questionnaire designed to elicit information on relevant legal rules and case law, and also on governmental attitudes to the issues involved".[2] Following this suggestion, the Secretary-General circulated a questionnaire to Governments under cover of a note verbale of 26 March 1976. The 35 replies which were received until 31 March 1977 are examined in the analysis reproduced in document A/CN.9/139.*

3. This report has been prepared in pursuance of the above decision, taking into account the information provided by Governments in their replies to the questionnaire and the views expressed by representatives to the Commission at its eighth session.

4. The consumption or the use of a product sometimes leads to injury or damage. Then, questions arise as to whether, from whom, under what circumstances, and to what extent the victim can get compensation. The report deals with these questions.

5. Civil liability for damage caused by products can be considered as a conventional subject of the law and as a new legal development. Traditionally, the liability for damage caused by goods with harmful qualities has primarily been viewed in the context of the contractual relationship between the seller and the buyer. Only in exceptional cases has liability for such injury been imposed under the general law of torts.

6. The new development is characterized by an awareness of the unique features of product hazards and by particular policy considerations that suggest the treatment of "products liability" as an independent subject of the law. Reflecting a growing concern for consumer protection, the new approach tends to be more embracing in that it extends to persons other than the immediate contractual parties and somehow eases the victim's burden of proving fault.

7. This evolution of products liability law is stimulated by such factors as: the considerable increase in production and consumption; the appearance on the market of new and complex goods which are often made in large-scale manufacture and complicated machine processes; the handing down of ready-made consumer goods to the ultimate buyers via long distribution chains; the use of containers and packages which minimize the possibility of exercising intermediate control; and the use of advertisements inducing consumer reliance. These and other contributing factors are primarily found in industrialized countries. But they are not without relevance to other States, firstly, because of increasing imports of industrial goods into such other regions, and, secondly, because similar economic developments are in these States under way and to some degree already existent.

8. It is in the context of world trade that the diversity in the law pertaining to products liability is most troublesome and gives rise to certain problems that could be mitigated by the adoption of a uniform liability scheme.

9. The following approach has been chosen for the present report. Part I examines the special features of products liability and evaluates general policy considerations. Part II discusses various concepts of liability with a view to determining an appropriate basis of uniform products liability. Part III sets out and evaluates the arguments pertaining to certain additional requirements and elements which relate to the scope and extent of liability. Part IV examines the insurance implications of such proposals pertaining to basis or extent of liability and considers further relevant issues of products liability coverage. Finally, suggestions as to a possible future course of action are submitted to the Commission for its consideration.

PART I. THE EVOLUTION OF PRODUCTS LIABILITY LAW: GENERAL POLICY CONSIDERATIONS

1. This part of the report will be devoted to an examination of the major policies which have influenced, if not determined, the development of products liability law as a unique régime of liability for product-caused damage. These policy considerations, which will be discussed under the three broad groupings of: (*a*) consumer reliance; (*b*) risk creation and control; and (*c*) cost allocation and loss spreading, are relevant not only to the determination of the basis and extent of a uniform liability scheme, but also to such issues as who should be made liable and for whose benefit.

2. However, useful as these policy considerations are, they cannot by themselves provide an easy solution to all the problems of product liability: their persuasiveness varies from one case to another and has to be assessed in the context of particular economic facts and social demands.

A. *Consumer reliance on producer*

3. The first policy consideration to be examined is "consumer reliance". The fact that consumers and users do not expect products to be dangerous is, of course, nothing new. Nevertheless, reliance on the safety of goods used or consumed has gained significant new dimensions. This reliance is shaped and accentuated by various factual changes in production and distribution patterns: large-scale manufacture, production of complex and highly sophisticated goods and modern distribution methods, at the apex of all of which stands a producer who is less and less likely to be a party to the final sales transaction with the ultimate consumer or user.

Evolution of consumer reliance rationale

4. Historically, the consumer reliance argument was first stressed in respect of packed or canned goods, particularly food. It was, for example, recognized in the famous British landmark decision of *Donoghue v. Stevenson* [1932] A.C. 562 which has been followed in many Common Law jurisdictions. In that case, the plaintiff had

[1] *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17* (A/10017), para. 103; Yearbook . . . , 1975, part one, II, A.

* Reproduced in this volume, section B, below.

[2] *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17* (A/10017), para. 102; Yearbook . . . , 1975, part one. II, A.

alleged injury as the result of consuming ginger beer from an opaque bottle which contained the decomposed remains of a snail. The guiding reason for liability, as expressed by one of the judges, was that the manufacturer had sold his products "in such a form as to show that he intends them to reach the ultimate consumer in the form in which they left him with no reasonable possibility of intermediate examination" (*ibid.*, at 599).

5. This idea helped to pave the way for the protection of consumers other than ultimate purchasers by imposing liability on producers who previously had been shielded by what has been called the "fallacious conclusion that the manufacturer of a defective article owed a duty to those alone who were in contractual privity with him".[1]

6. Such a shift in emphasis from the contractual party (usually the retailer) to the party on whom reliance was placed (often the producer) has not, however, been limited to situations involving packaged products, for there were concurrently other developments which came to be recognized as prompting legitimate consumer reliance. Foremost among these was the increasing complexity and sophistication of products which, as has been observed, "no longer permits the user to make an informed choice but forces him to buy on trust".[2] Indeed, as far back as 1953 Justice Jackson of the U.S. Supreme Court expressed similar sentiments in the following statement of the reason for the erosion of the doctrine of *caveat emptor* (buyer beware):

> "This is a day of synthetic living, when to an ever-increasing extent our population is dependent upon mass producers for its food and drink, its cures and complexions, its apparel and gadgets. These no longer are natural or simple products but complex ones whose composition and qualities are often secret. Such a dependent society must exact greater care than in more simple days and must require from manufacturers or producers increased integrity and caution as the only protection of its safety and well-being. Purchasers cannot try out drugs to determine whether they kill or cure. Consumers cannot test the youngster's cowboy suit or the wife's sweater to see if they are apt to burst into fatal flames. Carriers, by land or by sea, cannot experiment with the combustibility of goods in transit. Where experiment or research is necessary to determine the presence or the degree of danger, the product must not be tried out on the public, nor must the public be expected to possess the facilities or the technical knowledge to learn for itself of inherent but latent dangers."[3]

Multiplicity of products and consumer reliance

7. Consumer reliance is also influenced by the fact that more and more new items are continually being introduced into the market. The novelty factor is aggravated by the modern fact, lately realized, that some product hazards only materialize many years after the circulation and use of the dangerous products. In this connexion, one should bear in mind the fact that not every product-related injury is a momentary damage resulting from an accident and caused by a single defective product; an injury could be the result of a cumulative damage which developed gradually from the prolonged use of one or more products of the same or different kinds. This latter type of damage, as has been pointed out, "frequently cannot be specified, nor can the causality be completely clarified. The development is slow and cumulative, so that the presence of danger and of injury may not manifest itself for many years or for generations."[4]

Advertising and consumer reliance

8. Yet another factor shaping consumer reliance is the widespread and modern use of advertising. By various techniques of mass advertising, the manufacturer or sometimes the distributor represents his products to the public as suitable and safe for use or consumption. While it may be an exaggeration, perhaps even a gross one, to allege, as one commentator has,[5] that "a large proportion of mass products are consciously made as inferior as the traffic will bear and are advertised by conscious misrepresentation as far superior to their known quality" and that "[t]he combination of low quality production and high quality lying makes it impossible for those using the products of mass manufacture to distinguish good merchandise from bad without the services of a general testing laboratory," the fact remains that advertising does invite and achieve reliance, with varying degrees of success, a situation to which, it may be thought, the law should respond.

9. One other significant aspect of advertising is that it is largely indiscriminate in the sense that the advertiser addresses himself to the public at large, whether by newspaper, radio, or television, building up the psychology to consume his product. This invitation extends not only to potential purchasers but reaches other consumers or users as well. The advertiser thereby creates or strengthens demand for his product among, for example, family members or employees who in turn may influence the buyer's choice and later themselves rely on the safety of the product when consuming or using it. Thus, there is often a psychological connexion reaching beyond the ultimate puchaser, the last contract party in the chain of distribution.

10. Deserving of notice too with respect to advertising is the effect which advertising by the producer or wholesale distributor has on the retailer. The latter's choice as to what brands to carry depends largely on the consumer demand created by advertisements, and in his role as distributor he is often "no more than a conduit, a mere mechanical device, through whom the thing sold is to reach the ultimate user".[6] It is not surprising, therefore, that, according to one British survey, "most people believe that the primary responsibility for defects in products rests upon the manufac-

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[1] John G. Fleming, *The Law of Torts*, 4th ed. (Sydney, Law Book Company, 1971), p. 443.

[2] J. Comte, "Communication au nom de l'Union des Industries Chimiques", in *La responsabilité civile du fabricant dans Les Etats membres du Marché commun*, Aix-Marseille, Faculté de Droit et de Science Politique, 1974, p. 208.

[3] *Dalehite v. United States*, 346 U.S. 15, pp. 51-52.

[4] B. Dahl, "Product liability in Scandinavian law", *Scandinavian Studies in Law*, 1975, p. 64.

[5] Thomas A. Cowan, "Some policy bases of products liability", *Stanford Law Review*, vol. 17 (1965), p. 1087. The contrary view has been advanced that the producer may quite often be acting in legitimate response to consumer preference for lower quality goods at lower prices (McKean, "Products liability: trends and implications", *University of Chicago Law Review*, vol. 38 (1970), p. 59).

[6] William L. Prosser, "The assault upon the citadel (Strict liability to the consumer)", *Yale Law Journal*, vol. 69 (1960), p. 1123.

turer rather than upon the retailer".[7] However, such belief is not restricted to advertised products, being in part attributable to the other factors which create consumer reliance and in part to the fundamental idea that the producer creates the danger and is in the best position to control the risk.

B. *Risk creation and control*

11. The second of the policy considerations to be discussed, "risk creation and control", relates to society's reaction to the activities of some of its members which create the risk of loss to others. Proponents of liability for such activities argue that one who creates a risk which materializes in damage to others ought to compensate such victims for their loss. In other words, liability is justified, in the context of products liability, because the damage would not have occurred but for someone producing and circulating a hazardous product.

Risk control and deterrence

12. Besides this "risk creation" justification of liability if harm occurs, the very threat of liability is said to condition the producer, who is best able to control the danger, to be more safety conscious, thereby preventing injury in the first place. The deterrence rationale for product liability is succinctly set forth in a now classic statement by the American Judge Traynor, who said that: "Public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market. It is evident that the manufacturer can anticipate some hazards and guard against the recurrence of others, as the public cannot."[8]

13. Deterrence, like other policy goals, will not, of course, be achieved in all cases where protection is desirable. In various instances, for example, there may be no deterrent effect because producers already do their best to prevent injuries, particularly when they have to operate in the midst of strong competition. Nevertheless, it is not to be doubted that the extent of liability exposure is a motivating factor in most cases where additional safety incentives seem appropriate. Circumstantial evidence to this effect may be obtained from the experience in the United States where there has been a notable expansion of liability for defective products. A recent report of the U.S. Department of Commerce, for example, mentions "increasing production expenses, *i.e.* quality control, recall, redesign" as one of "the most significant effects of increased product liability".[9]

14. Manufacturers there have reportedly taken the following actions, among others, to protect themselves (as well as their insurers who often suggested or insisted on such measures): established national standards organizations; adopted standards set up by governmental agencies and national societies as performance minima; made increasing use of independent laboratory certifications; tightened up advertising and design; developed closer control on manufacturing methods and personnel; instituted better quality control procedures; expanded the risk management function; established independent corporate level safety watchdog committees; hired independent consultants; and, in the case of some toy makers, wholesalers, and dry cleaning companies, even dropped product lines.[10]

15. Providing incentives for greater safety and shifting the loss from the victim to the responsible producer could, each in its way, further the same public policy goal of consumer protection. Although it is impractical to expect maximum possible protection for the consumer, if only because the measures required to guarantee completely safe products under all circumstances would put the price of most products out of the reach of the average consumer, nevertheless, the deterrence objective of product liability can fairly be to secure as much protection for the consumer as seems reasonable, taking into account economic considerations as well as other policies.

The economic burden argument

16. The fear is often expressed that holding producers liable for damage caused by their defective products might subject them to too heavy an economic burden. This fear, though legitimate, appears sometimes to be exaggerated. In many cases, the cost of safety measures is minimal, particularly when compared with the amounts spent on advertising. It has been noted, for example, that the cost of reducing injuries from exploding soft drink bottles, through 100 per cent pressure testing, works out to less than two tenths of a cent per bottle, and that the cost of colouring poisonous polish, so children would not mistake it for milk or syrup, is next to nothing.[11]

17. Furthermore, all that may be needed to prevent injury in many cases is merely to require producers to give proper instructions and adequate warnings to the prospective consumer or user. Providing such information often costs less than other safety measures and would rarely constitute a crushing burden on the enterprise. There are also many instances where little or no costs are incurred in modifying the product or improving relevant quality control.

18. It may be noted furthermore that no economic burden is placed on the production of goods which are not apt to cause harm entailing liability. And even in those cases where risk of harm seems unlikely and yet cannot reasonably be excluded, the producer may well, for economic reasons, decide to accept the small risk that someone might be injured and he be made to pay compensation rather than incur the higher costs of product alterations or of more intensive quality controls. He is the one best equipped to make that decision because he knows the product, its prospective use, its weaknesses,

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[7] See *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 31.

[8] *Escola v. Coca Cola Bottling Co.*, 150 P. 2d 436 (Cal. 1944), p. 440.

[9] *Product Liability Insurance*, Report of the United States Department of Commerce (Washington, 1976), pp. 13, 15.

[10] Another indication of the potential deterrent effect of product liability is the success which has attended an annual "Product Liability Prevention Conference" which the New Jersey Institute of Technology has for the past seven years organized. The message of the workshop to manufacturers has been simply: "Use good manufacturing practice or else! Or else pay for product related injuries, for customer complaints, returns and replacements, for loss of business due to early product failures, and for inefficient methods of using labor and materials". (*Proceedings, PLP/76, Product Liability Prevention Conference* (Newark, New Jersey Institute of Technology, 1976), p. iii.)

[11] *Final Report of the National Commission on Product Safety* (United States, GPO, 1970), pp. 68-69.

and is most interested in keeping down his costs, including the cost of compensation payments.

19. Although therefore the threat of liability may in such a case have no actual deterrent effect, in so far as it does not bring about preventive measures, it is, nevertheless, a useful and necessary factor in forcing the producer to make that very decision.

20. The same consideration underlies the collateral reasoning for making the producer bear the risk of injury: "Where, in mass production, manufacturers find it more profitable to allow defects than to improve their standards of quality control, it may be argued that as between themselves and the injured person, the consequences of a defect should be borne by the manufacturer."[12]

21. This reasoning covers not only situations where the mere market conditions allow the profitable circulation of shoddy products, in which case additional liability seems needed as a balancing factor in favour of the victims, it applies also to instances where producers assign risks to consumers for reasons which are not necessarily reprehensible. Illustrations of that point are provided by the mass production method of sample testing.

22. In determining the sampling standard or the tolerance fraction, producers may set a relatively high level of the consumer's risk because they do not, perhaps cannot, exactly foresee and calculate the future risk exposure, or because they simply take a chance as entrepreneurs. It may also be that to a producer the setting of a lower risk level by intensifying the quality control would appear inadvisable, especially where the inspection of component parts of a highly complex product requires the destruction of the sample tested. Finally, the acceptance of a certain risk may be economically sound because the actual liability exposure is clearly lower than the costs of additional safety measures.

C. *Cost allocation and loss spreading*

The approach in general

23. The third policy rationale that has played a role in the development of products liability law is provided by the so-called "loss spreading" or "risk distribution" approach which argues for removing the economic consequences of accidents from the victim, and placing the risk on the enterprise in the course of whose business they arise. The risk, it is said, "becomes part of the cost of doing business and can be effectively distributed among the public through insurance or by a direct reflection in the price of the goods".[13]

24. Insurance, of course, by its nature and purpose, has a risk distributing effect. It eases the burden of the insured, providing him with fixed (premium) costs instead of uncertain liability exposure, and it spreads the risk over all policy holders, often utilizing the technique of reinsurance. Whilst this risk-distributing effect of third-party liability insurance is very important in practical economic terms and will be dealt with in a later part of the report devoted specifically to the subject (see part IV, below), it should be observed that it is not at the heart of the theory of product risk distribution. If liability insurance is taken out, the main and unique thrust of product risk spreading lies in the next step of cost allocation, as noted long ago by Judge Traynor of the California Supreme Court, who observed that:

> "The cost of an injury and the loss of time or health may be an overwhelming misfortune to the person injured, and a needless one, for the risk of injury can be insured by the manufacturer and *distributed among the public as a cost of doing business* . . . However intermittently such injuries may occur and however haphazardly they may strike, the risk of their occurrence is a constant risk and a general one. Against such a risk there should be general constant protection and the manufacturer is best situated to afford such protection." [Emphasis supplied][14]

25. The argument that the producer is the one best-situated to act not only as risk gatherer but also as risk distributor, spreading the loss over the community of consumers, applies not only to manufacturers who take out liability insurance and pass on the premium costs. Even with regard to self-insurers, who would pass on the costs of special money reserves or the expenses for meeting actual claims, one could adopt the same idea that "the loss should not be allowed to remain with the injured party on whom it fortuitously fell, but should be transferred to the manufacturer, who, by pricing his product, can spread it among all the consumers".[15]

26. In either case thus, the price paid by each consumer may be said to contain a small premium for accident insurance. To collect such contributions from all purchasers seems a good deal fairer than letting fate select the victim at random. To be sure, internal risk distribution amongst all buyers may operate whatever the basis of liability; under a fault system, for example, the premiums in the price of the merchandise are calculated to compensate for the consequences of fault. But the concept of what may be called here the "buyers' mutual benefit fund" and its resulting fairness tends to lessen the importance of the producer's wrongdoing and to emphasize the goal of compensating the unfortunate accident victims. It thus should be observed that the rationale of "enterprise liability", as this approach has come to be known, is not sufficiently expressed by the simple notion that the loss could be sufficiently redistributed by the proprietor of the enterprise: it rests rather on the additional consideration that spreading the risk

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[12] *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 32.

[13] See *Goldberg v. Kollsman Instrument Corp.*, N.E. 2d 81, 85 (New York 1963). The risk-spreading rationale has also been used by the American Law Institute in justifying its proposed special liability rule for physical harm to user or consumer as distinguished from purchaser: "Public policy demands that the burden of accidental injuries caused by products intended for consumption be placed upon those who market them, and be treated as a cost of production against which liability insurance can be obtained". *Restatement of the Law (Second), Torts*, vol. 2 (St. Paul, Minn., American Law Institute Publishers, 1965), comment (*c*) to sect. 402A, p. 350.

[14] *Escola v. Coca Cola Bottling Co.*, 150 P. 2d 436 (Cal. 1944), p. 441.

[15] John W. Wade, "On the nature of strict tort liability for products", *Insurance Law Journal*, 1974, p. 142.

via purchase price is itself reasonable and meets the demands of distributive justice.

Risk distribution not always possible

27. A general objection that has been raised against the risk distribution rationale is that it assumes that a producer is always able to pass the risk on to the buying public, which may not be so. The example is then posed of a regulated industry whose prices and other terms are fixed or subject to approval by a public authority which is less likely to let rate scales rise in reflection of increased liability. It is asked in such a case how likely it is that the additional risk will be effectively distributed as a cost of doing business.

28. Admittedly, the extent to which a manufacturer may be free to "spread the risk" created by his product is debatable. The following general remarks could nevertheless be made in partial response. Accident costs or premiums are not different from other costs, including prevention costs. Thus, they may also be regarded as part of the typical business risk which is subject to consumer demand and other market conditions. Even the extreme case where one producer is by no means able to pass on the risk of his liability exposure to consumers could be viewed as not necessarily disadvantageous. As has been observed, "should an enterprise, due to market conditions, be forced out of business because its accident rate, reflected in its prices, makes its products noncompetitive, its resources will be available for other endeavours so that in net effect, the nation's resources will be better allocated in terms of consumer preferences".[16] Although such reallocation of resources could serve the public interest in many cases, it should, of course, be avoided in others, particularly where socially desirable and necessary production is at stake.

29. Secondly, prohibitive costs are less likely to materialize in the real world in view of the availability of liability insurance with its primary risk spreading effect. At any rate, one could also point out here that producers stand to gain by their manufacture and distribution and profit from their endangering activity.[17] While this argument may not be thought to provide by itself a sufficient reason for imposing liability on the profit-seeker, it does seem, together with the other relevant policy considerations, to provide a basis for the initial loss allocation to him.

30. In this context, though, it should be admitted that the producer often is not the only one profiting from the distribution of the product and furthermore is not necessarily always the best risk absorber. If so, it could be argued that no good reasons exist for regarding such a producer as the risk distributor. An intermediate seller may, for example, be considered as the appropriate target of liability policies, particularly "when, as is now often the case, the large wholesale supply house is actually the prime mover in marketing the goods, and the manufacturer only a small concern which feeds it".[18]

[16] Friedrich Kessler, "Products liability", *Yale Law Journal*, vol. 76 (1967), p. 928.

[17] See, for example, *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, Her Majesty's Stationery Office, 1975), p. 30; Jacques Ghestin, "Exposé introductif", in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, *op. cit.*, p. 23.

[18] William L. Prosser, "The assault upon . . .", *loc. cit.*, p. 1142.

PART II. BASIS OF LIABILITY UNDER UNIFORM SCHEME

A. *Contractual promise (including warranty)*

1. In search of an appropriate conceptual basis for a uniform liability scheme one could first consider basing the right to compensation on the breach of a contractual promise, including warranty. The contracts law approach has the advantage of familiarity, being the common approach in matters pertaining to commercial law. In particular, damage caused by defective products involved in international trade is related to the subject-matter of the draft Convention on the International Sale of Goods currently under consideration by the Commission.

2. The contract approach would also seem attractive because the allocation of risks, like the determination of the other relevant conditions of the contract, would be left to the negotiating parties who could set the level of "consumer's risk" and tailor the scope of liability according to their specific needs and interests. And it may even appear preferable in terms of consumer protection because contractual remedies are often provided irrespective of fault, particularly in cases of breach of warranty.

3. There are, on the other hand, many reasons militating against a product liability scheme founded on contractual principles. The ordinary laws of contracts may be thought to contain various rules and requirements which could make it difficult to achieve just and reasonable results in the very special area of compensation for product-related damage. Judged against the general policy considerations discussed in the previous part, genuine contracts law, that is to say, traditional contracts law unsupplemented by legal fictions provides an inadequate basis. Its inappropriateness has indeed often been stated to be a major stimulating factor behind the modern development of extra-contractual product liability.[1]

4. There are numerous rules, for example, which, while making good sense in a commercial transaction or similar special relationship, seem much less suitable for application in the context of an ordinary consumer's recovery for product-caused injury. One such rule, for instance, is the buyer's affirmative duty to inspect the goods immediately; another is the requirement of giving notice in due time of any defects; a third example is the usually short period of limitation or prescription, and finally the subjective foreseeability of damage as a limiting factor to recovery.

Privity doctrine

5. The difficulties presented by these and similar rules may not, however, be insurmountable since one could well imagine appropriate remedial provisions in an instrument of uniform law. Yet there remains one major feature and inherent principle of contract law which has to be viewed as the main "defect" of contracts

[1] See, for example, Peter Prag, "A comparative study of the concept and development of products liability in the USA, Germany and Scandinavia", *Legal issues of European integration*, 1975, No. 1, p. 67; Paul M. Storm, "Product liability in Europe", in *Proceedings PLP 76, Product Liability Prevention Conference* (Newark, New Jersey Institute of Technology, 1976), p. 1; Friedrich Kessler, "Products liability", *Yale Law Journal*, vol. 76 (1967), p. 881.

law for the purposes of product liability: the classic doctrine of "privity of contract" which restricts rights and remedies to the contracting parties, thus depriving third persons of protection and recovery.[2]

6. To be sure, so long as manufactured goods reached the ultimate consumer via a single sales transaction, the producer's liability for defective goods did not present a special problem. However, with the advent of mass production, large scale promotion and elongated chains of distribution, all of which are typical features of international trade in goods, a new situation is presented. Requiring privity would mean that the manufacturer quite often would be insulated against direct liability to the ultimate purchaser (let alone any non-buyer).

7. Although there remains even in such a case the possibility that he may eventually be reached indirectly, by way of recourse proceedings in the chain of distribution, such revolving procedures may be interrupted by insolvency, lack of jurisdiction, limitation or disclaimer anywhere along the chain of contracts. Above all, such recourse procedures can be time-consuming and costly.

8. The idea of "short-circuiting" this rather cumbersome procedure has, therefore, rightly been advanced as a major policy argument in favour of imposing direct liability on the producer in the interest, not only of the consumer, but of the courts, and even of the suppliers themselves.[3] The aim of saving legal costs by allowing direct claims has also been noted by the English and Scottish Law Commissions, noting the English case of *Kasler v. Slavouski* (1928) 1 K.B. 78, in which there were four successive stages of indemnity for a retailer's liability to his customer who had contracted fur dermatitis.[4]

9. The difficulties of the privity requirement become most apparent in cases where a person beyond the ultimate purchaser is injured, e.g. the buyer's spouse, child, guest, employee, or donee. At least where personal injury or actual property damage is caused by defective products, the distinction between the contracting consumer on the one hand and everybody else on the other hand becomes difficult to sustain.[5] This is particularly so because it is often a matter of chance who will be injured by a defective product—the purchaser himself, his family, his guests or perhaps an outside third party.

10. This view derives from a recognition of the essential difference in function of contractual compensation and product liability. Contract remedies may be granted to make up for loss caused by the inferior value of the goods sold, i.e. to compensate the purchaser for not having fully received what he paid for. Such non-fulfilment of contractual expectations ordinarily results in economic loss due to the lowered value of the goods to the buyer, and it typically affects primarily the buyer as such. Product liability, on the other hand, aims at compensating any victims for injuries suffered from active malfunctioning of products. Therefore, the policies and liability reasons focus on the material fact that defective goods are circulated and reach consumers and users, the underlying contracts being viewed merely as the legal forms or "vehicles" of product distribution.

Warranty liability

11. The outlined distinction is also discernible, though less apparent, as applied to liability founded on warranties. While this device sometimes is favoured as a means of imposing liability irrespective of fault, its main function relates to matters and purposes different from the ones at stake in product liability. Firstly as to content, warranties rarely concern themselves with the safeness for use of the goods but rather with specifications bearing on the goods' value and usefulness, such as durability, fitness for special purpose, performance or output level. Furthermore, even where quality conditions relevant to safety are warranted, the ordinary remedy envisaged is not compensation for consequential injury but the genuinely contractual right of avoidance, reduction of purchase price, replacement or repair.

12. The one remaining situation of pertinence to product liability is the situation where consequential damage results from the breach of an express warranty of a safety-related nature (e.g. shatterproof windshield) or of an "implied" warranty that the product is safe for normal use or consumption. Even here, however, claims based on such warranties, whether expressly stated or implied, may, under pure contracts law, be brought only against the immediate seller as the other party in privity.

Legal fictions in aid of contracts law

13. One consequence of the obstacles posed by the privity doctrine to compensating victims of product-caused injuries was the evolution in many jurisdictions of a number of artificial devices and legal fictions designed to circumvent the privity obstacle in an appropriate case. Thus, for example, with respect to defective goods something like twenty-nine different theories were evolved at one time in the United States to sustain the conclusion that there was liability without negligence and without privity of contract.[6] Similarly characterized as "artificial" in this context is the French legal doctrine that the professional seller, particularly the producer, is presumed to know the defects in his goods.[7]

14. The need to resort to such artificial devices and legal fictions may be thought to reveal the basic inadequacy of ordinary contracts law as a basis for a product liability régime especially on the international level, leaving as the only alternative a concept of an extra-contractual nature. Such a concept could nevertheless incorporate the notion of warranties by defining "defect" with reference to particular consumer expectations.

15. The goal of equal protection for all product victims would seem furthermore to favour the enactment of uniform rules which are extra-contractual in the sense also that they are applicable irrespective of any existing contract between plaintiff and defendant. One would thus differ in this respect from the Hague Convention on

[2] As to this principle and certain exceptions thereto, see replies of Governments to questionnaire, Analysis, sect. II, A, Qs. 3 and 5, paras. 2-6.

[3] William L. Prosser, "The assault upon the citadel (Strict liability to the consumer)", *Yale Law Journal*, vol. 69 (1960), p. 1124.

[4] *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 32.

[5] See, for example, J. A. Jolowicz, "The protection of the consumer and purchaser of goods under English law", *Modern Law Review*, vol. 32 (1969), p. 6.

[6] William L. Prosser, "Products liability in perspective", *Gonzaga Law Review*, vol. 5 (1970), p. 160.

[7] See, for example, P. Malinvaud, "La responsabilité civile du fabricant en droit français", in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, *op. cit.*, p. 138.

the Applicable Law to Products Liability.[8] The question of the relationship between such uniform law and national contract rules, including uniform sales law, is a different problem which will be addressed later in this report. (See below, part III, H).

B. *Negligence*

16. The first concept of extra-contractual liability to be considered is "negligence" which constitutes the major cause of action in a tort system based on the fault principle. Under a "negligence" régime of product liability damages would be recoverable if a product-related harm was the result of negligent conduct, such conduct being defined as behaviour below the standard of care to be expected of a reasonable person in the situation at hand. This foundation of liability could even be viewed *a fortiori* as including intentional wrongdoing which by itself would be unsuitable as a basis of liability because of its rare occurrence.

17. Three main arguments may be advanced in favour of the negligence concept: its widespread recognition; its moral appeal; and its less burdensome effect on industry and business. In the following paragraphs, these reasons will be elaborated and evaluated, though only tentatively and generally. Their persuasiveness, it must be noted, depends very much on the policy objectives and value system against which they are judged.

Widespread recognition

18. The factor of widespread recognition is naturally of special relevance to the unification of law on a global level. As replies to the questionnaire on products liability show, liability for negligent conduct seems to be universally recognized.[9] In particular, it is in most countries the normal, if not the only, basis of extra-contractual liability for product-caused damage, although the extent of liability and the burden of proof vary considerably among countries. Furthermore, even those systems which impose strict liability tend to have concurrent liability for negligence. Thus, choosing negligence as the basis of a uniform product liability law would seem to have the advantage of harmonizing with existing legal rules and concepts.

19. Against this advantage one could post the following considerations: that the project of unification, if it should be embarked upon, would not materialize for many years to come; that by that time one would expect greater industrialization world-wide with many more countries having become industrialized or quasi-industrialized and still more well along a similar path; that with industrialization there is generally a trend, spurred by consumer protection demands, away from traditional negligence requirements and towards a stricter basis of product liability; that consequently it may be advisable to look ahead and anticipate such legal developments in a régime intended to govern well into the future. Indicative of the noted trend are the various projects of law reforms, not only on a national level, but also on the regional international level.

20. There are, for example, the draft directive of the Commission of the European Communities and the Convention of the Council of Europe, both of which propose a liability system that is stricter than negligence. The Committee of Experts of the latter organization, for instance, found "that the notion of 'fault'—whether the burden of proof lay with the person suffering damage or with the producer—no longer constituted a satisfactory basis for the system of products' liability in an era of mass-production, where technical developments, advertising and sales methods had created special risks, which the consumer could not be expected to accept".[10]

Moral appeal of negligence principle

21. Such regard for special characteristics could also help in evaluating the second reason stated in favour of the negligence concept, i.e. its moral appeal. The moral appeal of negligence as a basis of liability stems from the acknowledged moral principle that a person should only be held liable for his action if he is "at fault", that is, in this case if his action falls below a standard recognized by the law as reasonable and desirable. If his conduct is in conformity with that standard, he is on this principle not blameworthy. Furthermore, as between two persons, neither of whom is blameworthy, the loss should lie where it falls (*"casum sentit dominus"*). Thus, the fault idea is said to serve justice by exempting any defendant who is as innocent as the plaintiff.

22. To focus exclusively on personal guilt may not, however, be very appropriate in the particular context of product liability. If one followed the rationales for product liability discussed in the preceding part, particularly "consumer reliance" and "consumer's risk assignment", emphasis should be placed less on the blameworthy behaviour of a single person and more on the circulating of defective and dangerous products.

23. The solution of letting the loss lie where it falls may also be criticized on the ground that it is based exclusively on the two-party relationship between defendant and plaintiff. Such a view may be thought too narrow under the "theory of risk distribution" which, as has been shown, aims at spreading the loss over all buyers of the particular product involved. Its "buyers' mutual fund" effect serves the goal of distributive justice and from the point of view of fairness might well be adjudged to have stronger moral appeal than the principle of personal fault underlying the negligence concept.[11]

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[8] The second paragraph of article 1 of that Convention states that: Where the property in, or the right to use, the product was transferred to the person suffering damage by the person claimed to be liable, the Convention shall not apply to their liability *inter se*.

[9] Analysis, sect. II, B, 1, Qs. 1 and 2, paras. 2, 4-7.

[10] *Explanatory Report to Draft European Convention on Products Liability in regard to Personal Injury and Death*, Council of Europe, document CCJ (76) 41 add. IV, para. 10.

[11] The following historical note may be added to the discussion on the morality issue. It seems noteworthy that the fault principle, which today appears to be so deep-rooted and self-evident, was apparently not dominant at the early stages of civil liability. Like other legal systems, for example, the ancient Common Law "made a man act at his peril" and did not so much regard the fault of the actor, "as the loss and damage of the party suffering" (J. A. Kluwin, "Analysis of criticisms of the fault system", *Insurance Law Journal*, 1969, p. 390). Thus, until the industrial revolution in the nineteenth century, when civil liability was subjected to the general test of fault, the law basically imposed liability for causation rather than fault. As Fleming, commenting on this shift, observed: "We should hesitate to attribute this startling change of attitude to a 'moral advance' of the times; rather was it due to a calculated policy of encouraging the burgeoning industry of the new machine age". (John G. Fleming, *The Law of Torts* (Sydney, Law Book Company, 1971), p. 271.)

Protective effect of fault requirement on industry

24. The third, and in a sense strongest, argument in favour of the negligence concept is the fear that to dispense with the fault requirement could lay a prohibitive burden on industry, stifling growth and innovation especially of younger industries. This view which has been strongly voiced by business and other interested circles in industrialized countries in connexion with legal developments expanding liability for product-caused harm may well be thought to apply with greater force to the situation of those countries about to embark on or already in the midst of developing their industrial potential. The issues raised here are of critical importance and require careful consideration especially in a project of law unification within the framework of the United Nations. The following considerations may be thought relevant to an evaluation of these issues.

25. The first consideration is one of social policy. "No liability without fault" was a slogan of the nineteenth century philosophy of "laissez-faire", "the banner", it has been said, "of an individualistic society set on commercial exploitation and valuing property rights more highly than legal protection against physical injury".[12]

26. In contrast, industrial development is nowadays widely regarded as but one priority goal which should not be achieved in isolation from social development, particularly safe living conditions. This idea that economic growth should not infringe on the quality of life, but improve it, is of special relevance in the area of product liability and may be thought to lead to the conclusion that the development of production and trade should not be at the expense of fortuitous victims of defective products.

27. The protection-of-industry argument in favour of the negligence concept seems also to lose much force if one considers closely the export situation of developing countries in the absence of global unification of liability. A substantial and increasing amount of their products will be shipped into markets (in developed countries) where the law of the place, if applicable, as it often is, would subject them to liability irrespective of proof of fault. And in still many more countries they have to comply with often sophisticated and demanding safety standards, either by reason of competition or by virtue of import regulations. This means that if the trend in the developed countries continues, the situation would result in which only a few countries, usually developing countries, would remain as export markets in which the fault principle could, in practice, have any real protective effect for the industry of the exporting country.

28. Another reason which may be thought to undercut the protection argument as applied to developing countries is the direction of flow of industrial, liability-prone products. These, on balance, flow to rather than from the developing countries, suggesting perhaps that a uniform global compensation scheme without proof of fault might not necessarily work to the disadvantage of developing countries. Of course, the final assessment of net benefits depends on the particular situation of the country concerned as well as on the exact shape of the liability scheme proposed. It would appear to be true, however, for many developing countries that any possible loss of protection suffered by their young industries would be outweighed by the gains of consumer protection against foreign product hazards because such developing countries, even as they attempt to build up their industries, continue to import a large share of the industrial and consumer products they need.

29. A final consideration in this regard is the burden of proof. The difference between a negligence scheme and a system of liability without regard to fault is, in terms of liability exposure, a substantial one only if the plaintiff has the burden of proving negligent conduct on the defendant's part. But the plaintiff who has the burden of proof in a product liability case faces tremendous difficulties in trying to establish lack of reasonable care on the part of the producer or one of his employees, more so, if there is a foreign producer. Extraneous to the sometimes very complex process of production and unfamiliar with the internal control procedures of the producer, he would frequently find it impossible to discover and prove the necessary details constituting negligent behaviour.[13]

30. What all this may suggest is that the fault requirement with its focus on showing specific wrongdoing, assumed to be obvious and easily proven, is possibly not realistic under modern conditions.

31. A number of devices may be adopted, as already done in some systems, to try somehow to ease the plaintiff's burden of proof, while staying within the well-established negligence principle.[14] One could, for example, in some or all cases of product-caused damage regard the proof of a defect as *prima facie* evidence or as raising a presumption of fault which the defendant would have to rebut. One could also shift the burden of proof and have the defendant prove that there was no negligence on his part. Or one might treat any violation of statutory provisions, e.g. safety standards, as "negligence per se". This last method, i.e. viewing a statutory breach as conclusive evidence of negligence, would seem to be negligence in name only, being in effect indistinguishable from a substantive rule of strict liability.

C. *Strict liability*

Elements of strict liability

32. It is necessary at the outset to clarify the term "strict liability" and in particular to distinguish it from "absolute liability". Liability is said to be "strict" in this context because in contrast to negligence liability it is imposed without regard to subjective fault. But it differs significantly from "absolute" or "no-fault" liability, in that more is required of a plaintiff than proof merely that the product was a factual cause in producing his injury. He must go further and prove that the damage sustained by him resulted from a "defect" in the product. Absolute

[12] John G. Fleming, *op. cit.*, pp. 271-272.

[13] See, for example, J. Brouwer, "La responsabilité civile du fabricant dans les pays du Marché commun", in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, *op. cit.*, p. 30; Robert Patry, "Préface", in G. Petitpierre, *La responsabilité du fait des produits*, Genève, Librairie de l'Université Georg, 1974, p. VIII; *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 31.

[14] Analysis, sect. II, B, 1, Qs. 1 and 2, paras. 8 and 9, particularly replies by Australia, Barbados, Canada, Cyprus, Fiji, Germany, Federal Republic of, Pakistan, Sierra Leone and the United Kingdom.

or no-fault liability which requires proof only of causation but not of defect is more akin to the liability of an insurer. It is not here considered as a possible basis of unification because it is not known to have been adopted in any national product liability law, though it has been suggested by a few authors.[15]

Policy questions

33. The earlier discussion of the policy considerations for product liability,[16] when combined with the indicated limitations of either contract law or negligence as a basis for modern product liability law,[17] yields the policy rationales for strict product liability. If one agreed that the rationales of "consumer reliance", "risk creation and control", and "cost allocation and risk-spreading" justify the liability of a producer or distributor for harm caused by defective products put into circulation by him and if one furthermore were persuaded of the inadequacies of both contract law and the negligence principle in providing the desired scope of protection for the consumer, one would have but some form of strict liability as the remaining choice. Since these policy issues have, as indicated, already been covered, the remaining portions of this chapter will be devoted to a consideration of the major obstacles which might be encountered in unification on the basis of strict liability.

The defect requirement

34. A key element of strict products liability, which separates it from "absolute" liability, is the requirement that there be a defect, that there be "something wrong" with the product alleged to have caused harm. Essential though this element is, defining it in proper legal terms has proved extremely difficult. The importance of the requirement in any scheme of unification on a strict liability basis demands, however, that some elaboration of the requirement be attempted.

35. To do this one might first review various attempts which have already been made in connexion with other projects of this kind to assign a meaning to the term "defect". According to the European Convention (article 2c.) "a product has a 'defect' when it does not provide the safety which a person is entitled to expect, having regard to all the circumstances including the presentation of the product". But for the omission of the explanatory addendum beginning with "having regard to . . .", the definition in the Draft Directive of the European Communities (article 4) is essentially the same as the one just quoted. Section 402A of the American Restatement of Torts 2d, which has been approved by many courts, refers to "any product in a defective condition unreasonably dangerous to the user or consumer or to his property"; the comment to this provision then characterizes a product as defective "when it is not safe for normal handling and consumption", when it is "in a condition not contemplated by the ultimate consumer, which will be unreasonably dangerous to him" (comments (*g*) and (*h*), p. 351).

36. These and other definitions thus combine the notion of "defect" with the somehow modified idea of "unsafe" or "dangerous". Despite their similarity of use, however, each of the terms seems to serve a somewhat differing purpose of demarcation.

37. The term "defect" with its connotation of "something wrong" emphasizes a point which is not adequately expressed and clarified by mere "danger", for "dangerous products" could on the one hand be too extensively construed to include all products which are "dangerous" by their very nature and purpose (e.g. dynamite, gun, knife) or on the other hand be too restrictively interpreted as covering only those products which are generically dangerous, i.e. belong to a dangerous type or series, leaving out the category of individual items which contain foreign substances or other flaws resulting from mistakes in the manufacturing process.

38. On the other hand, the term "defect" standing alone seems insufficient, too, in that it might be too contractually interpreted in terms of "non-conformity" or even "unfitness for normal or special purpose". Furthermore, the term "defect" suggests primarily the result of a manufacturing error (a "flaw") and is less easily associated with the other important sources of product hazards, i.e. inadequate design and insufficient information, instructions and warnings, which from a policy viewpoint one might wish to include within the notion of "defect".[18]

39. Be this as it may, the crucial issue, it is submitted, is to establish the standard or required degree of safety. Though the yardstick of liability may be difficult to express in view of the great variety of goods, or product hazards, and of policy issues involved, substantive guidance can be gained by regarding the reasonable consumer's expectations as to the product's safety for normal handling, use or consumption. This is justified by the fact that it is the consumer whose expectations are relevant since it is he who is being protected by the law. The test of reasonable consumer expectations remains, of course, an imprecise one; but this has the advantage, of special importance in a uniform liability scheme for internationally traded products, of permitting one to take into account any local or regional particularities, including the "ordinary knowledge common to the community".

40. In applying this test, various factors would have to be considered and weighed. These include: usefulness and desirability of product, its utility to the user and to the public as a whole; likelihood that product would cause injuries and their probable seriousness; practicability of safety incentive, likelihood of future product improvement without impairing its utility; deterrent effect on development of new products; availability of safer substitute product; ability of user or consumer to avoid danger by self-protective measures or to bear the loss.[19]

41. It is perhaps an argument against this approach that to balance such factors and interests in applying the standard would certainly not be an easy task. The response to this may be that the difficulty involved is no greater than that encountered in determining, for ex-

[15] See, for example, Jeffrey O'Connell, "Expanding no-fault beyond auto-insurance: some proposals", *Virginia Law Review*, vol. 59 (1973), pp. 749-829; W. Freedman, "No-fault and products liability: an answer to a maiden's prayer", *Insurance Law Journal*, 1975, pp. 199-208.

[16] Part I.

[17] Part II, A and B.

[18] As to the various acts or omissions entailing liability, see Analysis, sect. II, B, 1, Qs. 1 and 2, para. 14.

[19] See, for example, David A. Fischer, "Products liability—The meaning of defect", *Missouri Law Review*, vol. 39 (1974), p. 359. John W. Wade, "On the nature of strict tort liability for products", *Insurance Law Journal*, 1974, p. 151.

ample, the "duty of care" or the "reasonable man standard" in traditional negligence cases. Furthermore, it is not uncommon, and has been considered good legislative practice, for a piece of legislation designed to govern myriad fact situations, some of which cannot be anticipated in advance, to incorporate a flexible and general standard by which judges are enabled to deal with unexpected fact-patterns and new situations.

Development and system risks

42. Two kinds of product risks create special problems. One of these is the so-called "development risk" which refers to an unsafe condition in a product not discoverable using the scientific knowledge available at the time of its circulation. The other one, though sometimes treated as a form of "development risk", may be termed "system risk" and concerns products with known dangerous conditions which cannot however be eliminated using known technology.

43. In view of the inevitability of danger, common to both risks, imposition of liability may be regarded as unfair and a too heavy burden on defendants. Particularly in the case of development risk, one could point at the incalculability of possible losses and reject liability because it would discourage innovation and progress while not providing any safety incentive.[20]

44. One might on the other hand consider imposing liability in such cases (as is, for example, proposed in both European texts) for the following reasons. If economic development adversely affects human life or health, compensation even for "unavoidable" injuries may be viewed as good social policy because otherwise, it is argued, victims would be sacrificed as "guinea pigs" for the public good. As to "unavoidability", one could argue that, in practice, it is often a matter of money and commitment for the requisite scientific or technological knowledge to be gained in time to avert the risk. Furthermore if the dangerous condition was by no means detectable, the plaintiff himself will often be unable to determine the cause of his loss and to furnish sufficient scientific proof.

45. This last factor may account for the fact that actual cases of development risks are very rare in the case law.[21] System risks appear to be rare, too. Major examples are blood containing the hepatitis virus and vaccine for the Pasteur treatment of rabies. Development and system risk cases should, it is thought, be decided on their specific merits. This might entail, for example, denying the plaintiff's claim on the ground that the product was not unreasonably defective and providing compensation to him through some other device such as by national health compensation, or imposing liability and possibly easing the burden on the defendant by state subsidy in light of the over-all utility of the product involved.

46. The latter solution could also be ultilized to encourage the development of highly needed but potentially risky products. Furthermore, inclusion of all these cases in the liability scheme would prevent defendants from raising the state-of-the-art defence in many unjustified situations. It would in addition accord with reasonable consumer expectations, which arise from the implied representation that the product is safe, to include all such cases,[22] and relate liability more to the final condition of the product than to any acts or omissions occurring in its production. Above all, in view of the actual rarity of both kinds of risks, it may well be that one could point to the policy of objective of risk distribution, including risk spreading via insurance, as an adequate response to the frequent call for exclusion from liability coverage of development and system risks, calls which may often be motivated by traditional ideas of fault and foreseeability.

Strict liability and negligence: similarity

47. If one were to separate the requirement of fault from the issue of who has the burden of proof (the injured plaintiff or the producer-defendant?) one would very likely come to the conclusion that a strict liability and a negligence régime differ in operation not by reason of the fact that the latter requires "fault" and the former does not, but rather because in a negligence régime the burden usually is on the plaintiff to prove fault and not on the defendant to prove lack of fault. If the latter would be the case, either because the burden has been legislatively placed on the defendant or because the courts, moved by a consumer protection consciousness, begin to operate under a tacit presumption of fault which it was up to the defendant to dispel, the result would be strict liability in fact.

48. This is so because, as has been observed, "a manufacturer will rarely be able to convince a court that no negligence was involved when a defective product was put into circulation".[23] This state of affairs reflects not so much a consumer bias as the widespread belief that except for development or system risks, which by definition may materialize in the absence of fault, almost all "unreasonably dangerous conditions" or "safety defects" are due to some kind of human misconduct in the planning stage or the production process.[24] Thus, strict liability is not far apart from a negligence system with a reversed burden of proof, as is often recognized by courts in requiring a very high degree of care.[25]

49. That both concepts are very close means in practical terms similar liability exposure and similar safety incentive for the producer. Although exact statistical data are still lacking and differences may exist with regard to particular products, supporting evidence may be seen in the experience of the United States where it is reported that "insurance practices permit a manufacturer to insure his products at roughly the same cost whether he makes them in a negligence or a strict state".[26] In the régimes there referred to negligence liability is reinforced by some version of *res ipsa loquitur* or a practical equiva-

[20] See, for example, Richard E. Byrne, "Strict liability and the scientifically unknowable risk", *Marquette Law Review*, vol. 57 (1974), p. 675; David A. Fischer, "Products liability . . .", *loc. cit.*, p. 350.

[21] See, for example, John G. Fleming, "Draft convention on products liability (Council of Europe)", *American Journal of Comparative Law*, vol. 23 (1975), p. 732, as to United States experience.

[22] See, for example, Paul D. Rheingold, "What are the consumer's 'reasonable expectations'", *Business Lawyer*, vol. 22 (1967), p. 598.

[23] Werner Lorenz, "Some comparative aspects of the European unification of the law of products liability", *Cornell Law Review*, vol. 60 (1975), p. 1012.

[24] William L. Prosser, "The assault upon . . .", *loc. cit.*, p. 1114.

[25] Analysis, sect. II, B, 1, Qs. 1 and 2, paras. 6 and 7, particularly replies of Australia, Burundi, Canada, Cyprus, Germany, Federal Republic of, the Netherlands, Norway, Pakistan and Sweden.

[26] Note, "Products liability and the choice of law", *Harvard Law Review*, vol. 78 (1965), p. 1456.

lent.[27] The difference in costs would presumably be greater if the situation under strict liability were to be compared with that under traditional negligence. However, as already observed, this latter concept, with the burden of proof resting on the plaintiff, might not be thought a suitable basis for a uniform international product liability régime, in view particularly of the great difficulties in proving fault.

50. If the choice then were reduced to either a strict liability or a modified negligence régime, the better course of action would seem to be to drop the fault idea altogether and opt simply for strict liability. This would have the advantage at least of saving on the costly procedural and other complicated legal manoeuvrings typically associated with a negligence trial,[28] while presumably not providing less deterrence or more liability exposure.

51. It may also be pointed out in this connexion that producers and other sellers, to preserve or foster their business goodwill and also to save on legal costs, not infrequently prefer to pay compensation regardless of the issue at fault. Finally, it should be stressed, firstly, that the economic impact of liability rules varies considerably according to market conditions and the social climate, including the claim-consciousness of the consuming public,[29] and, secondly, that no final assessment of the relative merit of any particular liability scheme seems possible until one has considered the detailed features of such a scheme. It is proposed in the next part of this report to elaborate and consider the elements of a possible uniform liability scheme for products involved in international trade.

PART III. ELEMENTS AND SCOPE OF UNIFORM LIABILITY

A. *Persons incurring liability*

Producers

1. The first task in defining the elements and scope of a uniform product liability régime is to identify the persons on whom liability should be imposed. One obvious target of such liability is the producer, the term referring not to the single workman involved in the actual making of the product, but to the natural person or legal entity owning, controlling and profiting from the production enterprise.[1] As the earlier discussion on general policy considerations has shown, he often is the one who invites consumer reliance, creates and controls the risk of harm, and is placed at the most efficient point in the distribution chain to gather the risk and spread the losses. Indeed, the guiding General Assembly directive, resolution 3108 (XXVIII) of 12 December 1973, refers to "uniform rules on the civil liability of producers for damage caused by their products".

2. In addition to the principal producer, other independent persons may be involved in the production process, the most notable example of these being suppliers of component parts. Whether or not to include such suppliers within the concept of "producers" raises difficult questions of policy. The following considerations favour their inclusion. Firstly, inclusion would add another level of protection for the consumer, which could become important in cases where the component producer is a much larger enterprise than the final producer or assembler.[2] Secondly, applying the risk creation and control argument, it seems appropriate that the supplier of a part incorporated in another product should be held accountable where the unsafe condition of the final product arises out of a "defect" in his own product. This argument becomes particularly valid in the situation, common in practice, where the supplier has more experience and knowledge about his specific product and its potentially harmful features than the final assembler.[3]

3. Arguing, on the other hand, for a different treatment of the component supplier is the fact that the quality and harm potential of the component part depend sometimes on the specific technical instructions given by the final producer and always on the actual use to which such part is put by him. The solution perhaps is to have a separate rule which would impose liability on the component supplier only if the component part itself is "defective" in the sense alone that it does not provide the level of safety reasonably to be expected, having regard to its typical use or to the use made known at the time to the supplier. The supplier thus would not be liable if, for example, the component part were put to a different or an atypical use or were unsuitable for the purpose for which the principal producer had on his own design initiative decided to use it, thereby rendering the final product defective.

4. There are, apart from component suppliers, other independent parties who may be implicated at the production stage of goods. These may include design professionals, testers and endorsers, and even lessors and licensors. This category of persons could, it is thought, justifiably be left out because their involvement is often sporadic, marginal and not easily delineated.[4] An exception could, however, be considered for those cases where such persons under their own name invite consumer reliance, for example, by endorsing the product on labels or in advertisements. It may be noted that both Euro-

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[27] William L. Prosser, "The assault upon . . .", *loc. cit.*, p. 1114.

[28] See, for example, *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 32.

[29] For more detailed consideration of this point, see part IV.

[1] The producer is in fact the person most frequently mentioned in the replies to the questionnaire as a potential defendant under the extra-contractual liability notion; see Analysis, sect. II, B, 1, Q.3, para. 1 (*a*), (*b*). As to employees, although their liability may be theoretically recognized, especially under compensation rules based on personal fault, recovery is in practice rarely sought from them, but almost exclusively from the employer who, having more resources, is made to answer for his employees' acts or omissions ("*respondeat superior*"). And as to strict liability, it obviously is unsuitable for application to an employee, since it is objective, attached to the commercal circulation of defective products, and based on the ability of the enterprise to spread the loss, via purchase price.

[2] See, for example, "Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, Explanatory memorandum", in *Bulletin of the European Communities*, 1976, Supplement 11, pp. 14-15.

[3] Suppliers of component parts are specifically mentioned as potentially liable in the replies of Australia, Barbados, Madagascar, and the Union of Soviet Socialist Republics; see Analysis, sect. II, B, 1, Q.3, para. 1 (*c*).

[4] See, for example, Note, "Liability of design professionals—the necessity of fault", *Iowa Law Review*, vol. 58 (1973), pp. 1223-1236; Note, "Torts—negligent misrepresentation—liability of non-manufacturer certifiers of quality—endorser of defective products for pecuniary gain may be liable to purchaser whom product injures", *Georgia Law Review*, vol. 4 (1970), p. 632; W. A. Wiseman, "Strict liability of the bailor, lessor, and licensor", *Marquette Law Review*, vol. 57 (1973), p. 137.

pean texts propose liability for "any person who, by putting his name, trademark, or other distinguishing feature on the article, represents himself as its producer".[5]

Commercial distributors

5. A basic question is whether, under a uniform scheme, liability should be imposed on persons other than "producers", namely, wholesalers, middle-level distributors and retailers.[6] The argument against imposing liability on these is essentially that such persons ordinarily neither create nor control the risk but merely transfer the goods as they are. Thus, is it argued, they are not a suitable target for the policy of deterrence, i.e. harm prevention by the operation of safety incentives.

6. Other considerations however argue for the imposition of liability on such distributors. Firstly, importers, wholesalers, and retailers, particularly large ones, often conduct quality and safety tests themselves and are in a good position to know about previous instances of similar product defect. Secondly, the goal of deterrence would be served, directly in those cases where the defect results from the distributor's own malfeasance, such as improper handling or storage, and indirectly in the fact that the innocent distributor who is made to pay compensation usually can obtain indemnification from his supplier or the producer. Thus, even a retailer could be regarded as a "conduit through which to pass the burden of the risk of loss back to the manufacturer where it really belongs".[7]

7. Consumer protection provides a further justification for imposing liability on distributors since the producer, particularly in the case of an imported product, is often less accessible to the plaintiff than the domestic distributor. One method which has been proposed for alleviating this hardship, which may be aggravated by disputes over jurisdiction and enforcement, is therefore to subject the importer to liability, as is proposed in both European texts[8] and recommended by the Ontario Law Reform Commission in Canada.[9]

8. Finally, the liability of distributors in general may be supported by the rationale of consumer reliance and by the policy of risk distribution. Sellers quite frequently invite reliance by advertising in newspapers or in stores, and on radio or television, often issuing specific recommendations and promises; and, like the producer from its production, they stand to gain from the distribution of the product. Furthermore, they could, though on a lower level than the producer, spread their loss or insurance costs over the buyers through pricing.

9. Most of the reasons stated in favour of distributors' liability are valid only in respect of those persons engaged in some business of product distribution. Therefore, it is submitted, liability should be imposed only on professional, commercial sellers or similar distributors such as, for example, persons transferring goods in the context of rendering services, and should not extend to a sale by a party not engaged in the business of distributing products (e.g. sale between neighbours) or to a non-commercial distribution (e.g. by mother to child, host to guest). By the same token, in view of the policy target of product liability, i.e. the commercial circulation of defective products intended for use or consumption, the liability of commercial distributors or producers should remain unaffected by the fact that there has been such private sale or non-commercial distribution in the distribution chain.

Channelling of liability

10. The foregoing review of potential defendants reveals that liability could in principle be imposed on numerous categories of persons involved in the production and distribution of a product causing harm. A régime which would hold all or most of these persons potentially liable would, however, encounter many practical problems. There most likely would be uncertainty and confusion as to who would be the most appropriate defendant in a particular case. There would certainly be problems relating to recourse actions based on internal indemnities and other devices of loss-shifting; and most significantly, there would be a multiplicity of duplicate insurance coverages, with attendant cost consequences, as essentially the same liability risk would be covered by every potential defendant. The practical measure which has been devised to combat these problems is to single out one such potential defendant and to "channel" liability to him.

11. Channelling of liability has the advantage that legal responsibility can be more clearly ascribed in any given case and, by relieving all but one defendant from the need to effect insurance for appropriate indemnities, avoids "the pyramiding of insurance".[10] Details of these insurance consequences, including related benefits such as cost savings and enhanced loss predictability, will be discussed later in the separate part on insurance (part IV, especially paras. 31-34).

12. The device of channelling is one which is well known in international conventions. It has most notably been used in conventions regulating liability for nuclear damage, where there exists both a need to ensure that someone has clear responsibility for compensating the victims, and thus for taking out the necessary insurance, and the possibility of costly duplication of insurance if every potential defendant had to provide for the very high exposure potential involved.[11] Channelling also lies at the heart of joint insurance plans by which coverage is provided for the suppliers of aircraft component

[5] Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 2; European Convention on Products Liability in regard to Personal Injury and Death, article 3,2.

[6] Such persons in the chain of distribution are noted as potentially liable in the replies of quite a few countries. See Analysis, sect. II, B, 1, Q.3, para. 1 (*a*), (*d*).

[7] Note, "Tort—strict products liability for retailers?", *Washington Law Review*, vol. 45 (1970), p. 439; see also Geneviève Viney, "L'application du droit commun de la responsabilité aux fabricants et distributeurs de produits", in *La responsabilité des fabricants et distributeurs*, Recherches Panthéon-Sorbonne (Université de Paris I, Paris, Economica, 1975), p. 94.

[8] European Convention on Products Liability in regard to Personal Injury and Death, article 3,2; Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 2 (for "import into the European Community").

[9] See John G. Fleming, "Draft convention on products liability (Council of Europe)", *American Journal of Comparative Law*, vol. 23 (1975), p. 735.

[10] John G. Fleming, "Draft convention . . .", *loc. cit.*, p. 734.

[11] See, for example, (OEEC) Convention on Third Party Liability in the Field of Nuclear Energy, Paris 1960, article 6 (*a*) and Vienna Convention on Civil Liability for Nuclear Damage, 1963, article II, 5.

parts,[12] and it underlies the proposal in both European texts to impose strict liability in the main on producers, excluding retailers and other sellers.[13]

13. It seems clear from the foregoing account of channelling that this device is most effective, and its advantages best realized, if it is adhered to systematically and few exceptions admitted to the principle. Thus in contrast to the Council of Europe's Convention in which the liability of retailers and other sellers under non-convention law is left untouched and several other exceptions admitted to the exclusive Convention liability of the producer (most notably the imposition of liability on the importer), the scheme under consideration should, it is suggested, adopt a strict form of channelling. This would mean that every effort should be made to settle, if possible, for a single exclusively-liable defendant and to make the uniform scheme the exclusive liability régime with respect to matters covered by it.[14]

The importer as target of channelling

14. The next step, assuming that channelling were favoured, would be to decide to whom liability should be channelled. All the reasons which were identified as arguing for the liability of the producer would seem also to point to him as the most suitable target of channelled liability. However, convincing reasons could be advanced in favour of channelling liability for damage caused by internationally distributed products rather on the importer, or, as he may be conveniently termed, the "first national (domestic) distributor".

15. First, there are all the arguments advanced in favour of imposing liability on distributors (including importers), such as their greater accessibility and the possibility of thereby avoiding complex issues of jurisdiction and enforcement. Secondly, the importer, as compared to the foreign producer, is apt to be more familiar with domestic safety regulations, normal product uses, specific national laws and compensation features. He is in a better position to know earlier of injuries, to give warnings, stop distribution, or organize recalls. Furthermore, he is often the most active promoter of the product within the territory involved and may even distribute products under his own name and without mention of the foreign producer.

16. A rule that would channel liability exclusively to the importer may, however, need modification in at least one respect. Channelling to the importer contemplates the typical case where the product is imported for redistribution, with the importer being the first of possibly many distributors or even the only one. Where, however, the importer buys for his own use and himself suffers damage (e.g. his factory is set on fire by defective imported machinery), the conceptual difficulty arises under channelling that the importer then has no remedy except against himself.

17. This situation could be dealt with in a number of ways. One would be to expressly exclude it from the scope of the uniform product liability régime, leaving the importer to pursue his traditional remedies, contractual and otherwise, against his supplier or manufacturer. The other would be to expressly provide in the scheme, as an exception to the importer's exclusive liability, that the importer may recover directly from the producer in such a case. The third, and perhaps least desirable, alternative would be to say nothing in the rules about such a case. The result of this would almost certainly be a divergence in interpretations by the courts, with some holding that, the case not being provided for under the new régime, the importer was free to seek remedy under traditional law outside the uniform rules, and other courts holding that the intent in not providing for this case was to let the loss lie on the importer where it had fallen.[15]

18. Finally, it may be noted that although channelling liability to the importer rather than the producer reduces the opportunity for risk distribution from a global to a national scale, the difference in practice may not be significant since much would depend on factors such as the size of the producer's operation and the extent to which he actually spreads the loss from one market territory over the other territories rather than simply making the price in each territory reflect the experience within that market. At any rate, for many importers the market over which their loss is spread is the entire national market, which for this purpose may be sufficiently sizable. Also as will be discussed later in relation to insurance (see part IV), the possibility exists of shifting the importer's loss directly or indirectly back to the producer, thereby achieving in effect risk distribution at the producer level. The devices for accomplishing this might include, for instance, a contractual indemnification arrangement, price adjustments, the taking out of insurance by the producer naming the importer as an insured or even assumption by the producer of the obligation to pay the premium on the importer's liability insurance.

B. *Scope of application of uniform rules*

Products of foreign or domestic origin

19. The first issue of relevance to the scope of application of a uniform liability scheme such as is under consideration is whether the scheme should cover damage caused by products both of domestic and foreign production or should simply be limited to products of foreign (i.e. international) origin.

20. This, of course, is a policy question which cannot be resolved in this report and one which the Commission may wish itself to address at an appropriate juncture. It may, however, be observed, briefly, that in favour of not limiting the scheme to imported products is the consideration that to so limit it might create in countries in which the prevailing products liability régime provides a lower standard of protection to the consumer than is provided under the uniform scheme (e.g. negligence as against strict liability) a situation in which the buyer has an incentive, based on his differing

[12] John G. Fleming, "Draft convention ...", *loc. cit.*, p. 734.

[13] See, for example, Werner Lorenz, "Some comparative aspects of the European unification of the law of products liability", *Cornell Law Review*, vol. 60 (1975), p. 1025.

[14] The relationship of the scheme being considered to relevant national law is discussed later in this report, subpart I below. For a critique of the European Convention in draft form, see John G. Fleming "Draft convention ...", *loc. cit.*, p. 734, where the author remarks of that convention that it "merely toys with the goal [of channelling] without pursuing it systematically".

[15] The problem of the importer-consumer should in practice not be as serious as the foregoing theoretical analysis would suggest, at least in the case of a business entity. This is because such an importer would most likely carry some other form of business insurance which would cover losses of the kind under discussion.

legal position with respect to each, to choose a foreign product over an identical domestically produced one.

21. On the other hand, it may be thought that damage caused by domestically produced products do not raise the sort of considerations (e.g. inaccessibility of foreign producer) which justify the elaboration of an international uniform liability scheme, and that, furthermore, it is appropriate that a scheme such as is envisaged limit itself to activities having an international repercussion. Thirdly, although it is not clear that the issue was being specifically there addressed, General Assembly resolution 3108 (XXVIII) of 12 December 1973, paragraph 7, refers in this context to "products intended for or involved in *international* trade or distribution" (emphasis added), which appears to direct attention to imported rather than domestically produced products. Attention has consequently been focused in this report on the international rather than the domestic aspect of products liability.

The "international" element

22. Assuming then that only products of foreign origin would be embraced within the scheme under consideration, the question arises as to what international nexus should be recognized. One could think of two basic approaches. Under the first, it would in general be sufficient to invoke the uniform rules that the product causing harm was produced in a country other than the one in which injury occurred.[16] The other approach would make the scheme cover only products which have been the subject of an international sale or distribution.

23. The principal advantages of the first approach are, firstly, that the test would be easy to apply, since there would be no need to inquire whether somewhere down the line there had been with respect to the product involved an international sale or distribution; and, secondly, that it would reduce the temptation for an organization to seek to avoid its liability exposure by arguing that a product made abroad by its branch or division (not a separate legal entity) was not covered by the uniform rules, since the product was not the subject of a sale or distribution, having simply been made by the organization for itself.

24. On the other hand, in favour of the second approach is the argument that the type of cases which would be covered under the first approach and not under the second might be precisely those cases with respect to which no need exists for an international liability régime since they do not, for example, raise any problems of the producer's inaccessibility to the injured plaintiff. At any rate, the pertinent General Assembly resolution cited above does refer to "international sale or distribution", implying, it would seem, the second approach.

25. As to the second approach, the term "sale or distribution" appears to indicate that forms of distribution other than sale are to be included. This construction appears sound from a policy perspective in that although sale is the most relevant and frequent type of product distribution, the exact character of the international link in the often long distribution chain has much less significance in the context of products liability than it does in the context of, say, the special rules governing the rights and duties of parties to a contract. Here, the actual fact of product distribution would seem more important than its legal form or vehicle, bearing in mind especially the feasibility of risk spreading via price.

26. One would, therefore, consider bringing within the scope of the rules not only distribution by sale, but such other forms of distribution as, for example, leasing, hire-purchase, barter, and franchises or similar service contracts. In order, however, to underline the business nature of the transaction and to exclude cases not warranting liability under the uniform scheme (e.g. charitable aid or grant, private sale or a similar transaction across the border), one would presumably require that the distribution be "commercial".

27. The "international" character of the distribution is the next important element to be considered. The simplest and most common case of international involvement would be where products are produced in one country and from there commercially exported into another one. In other cases, there may be two or more international links in the chain of production and distribution. However, in view of the major goals of unification, one such link should be sufficient to bring the case within the ambit of the uniform liability scheme.

28. The requirement that the chain of distribution end in a country other than the one of production needs clarification in two respects. The first difficulty stems from the fact that it is not always that products are produced, assembled, and packed in the form in which they are intended to reach the ultimate user or consumer, all in one country. Thus, the decision would have to be made whether the uniform rules should also govern those cases where the only "importer" somehow contributes to the final production, e.g. by changing certain features, assembling, packing, bottling, dividing into smaller units. Should it be decided to include such cases, it would be advisable to specify the kind or degree of work which such a party might do and still remain an "importer" for this purpose. This would make it possible to exclude cases of essentially domestic manufacture though involving some imported ingredients or component parts. Inclusion of such domestically finished products, particularly if broadly defined, would appear more defensible if the importer would be the only person to whom liability would be channelled.

29. The second point relates to the case of the importer-consumer discussed above (paras. 16, 17). As there noted, one solution to the problem might be to expressly exclude the case from the uniform régime. If so, this could be done by reading into the definition of "international distribution" the requirement that the product originate in a country other than the one in which the last distributor had his place of business.

C. *Types of product covered by uniform liability scheme*

Movables, including those incorporated into other movables or into immovables

30. One issue to consider in relation to a uniform products liability scheme is what kind of product, applying the traditional classification of property into "movables" and "immovables", should be covered under the scheme. Few would doubt that pure movables, by far the preponderant kind of product involved in products

[16] An exception might then be considered for certain special cases, such as where the injured party himself bought the product while abroad and brought it into the country of injury.

liability cases, should be included. Similarly many would agree that pure immovables should, on the other hand, be excluded, although the dividing line is not easy to draw in some instances (e.g. pre-fabricated houses, oil-rigs, machines fixed to the land). It may be observed in this connexion that production of immovables (such as construction of buildings) seems to be relatively rare in the international context and is often, where it occurs, subject to specific régimes of liability.

31. Some doubts exist with regard to mixed cases where movables lose their individuality. If they are incorporated into immovable property, one could follow the rule of exclusion and the considerations relating to immovables as such. However, inclusion of such cases might be favoured as the special régimes regulating such situations tend to focus on the immovable as a whole and to overlook the liability of producers of parts incorporated into such immovable. Inclusion would also allow one to treat the incorporation by the "distributor" (constructor) like the practically similar case of incorporation of a component into a movable product by the last buyer or user. Similar treatment would be accorded movables incorporated into other movables. In support of the foregoing proposals are those reasons earlier advanced as favouring the liability of suppliers of component parts.

New products, low-quality items, second-hand goods

32. While there is little doubt that new products, being the typical object of products liability, should be included in the scheme, there may be the point of view which would question the wisdom of including low-quality and used items within the scheme, to the extent at any rate that these categories of products are not accorded special treatment. The argument would be that imposing strict liability for such products ignores possible consumer preference for low-quality bargains. However, lower quality in, for example, second-choice china or furniture does not ordinarily affect safety. In the exceptional case where it does so, it would be only to a small degree and this could be taken into account in applying the test of "defect" having regard to reasonable consumer expectations and in evaluating appropriate defences (e.g. assumption of risk, third-party intervention).

33. Similar considerations would apply to used products. Although consumer expectations here are typically lower, there remains some reasonable reliance on there being no original defects in the products (as distinguished from the results of normal wear and tear or misuse). Besides, actual liability would be rare in practice, reducing the possibility of undesirable results, owing to the inherent difficulties of proof and to the possible expiry of the limitation period. On the other hand, in view of the small amount of used items in international trade relative to over-all volume, one could also consider excluding this category altogether from the uniform scheme.

Manufactured products, items of industrial mass production and of small-scale manufacture

34. Industrial goods produced in large series are clearly the main target of the general policies in favour of products liability; this becomes clear when one considers, for example, the rationale of the assignment of risk to the consumer through the setting of the control standard under the sampling method of quality control. However, items of small-scale manufacture may also be subjected to liability because the same rationales apply here too, though perhaps not with equal force, and the dividing line is difficult to draw.

35. In addition, manufactured items not industrially produced in series are not the most common goods in international trade, and they tend to fall into one of two categories, inclusion of which in the uniform scheme should cause no great harm. Either they are very complicated, valuable pieces, with a relatively high risk potential on whose operational safeness the buyer is strongly invited to rely (e.g. special machinery), or alternatively, they are simple, inexpensive pieces, such as handicrafts, which generally are less hazard-prone or at least not unreasonably dangerous according to ordinary consumer expectations (e.g. textiles known not to be colour-fast).

Natural products

36. Primary natural products, particularly those of agriculture, farming, and fisheries, present special problems which require careful consideration. Calls for their exclusion from uniform liability, particularly one entailing strict liability, focus on the fact that the products are "natural", are only harvested and forwarded by farmers or fishermen in more or less the same state they occur in nature. However, these products, particularly as found in international trade, increasingly bear the mark of human intervention, being often processed or somehow treated, for example, with chemical fertilizers, insecticides and preservatives. Thus, their inclusion might be justified on the basis that such human intervention could bring about harm to the consumer.

37. One specific aspect of the "natural" quality argument deserves special notice. This is the argument that various kinds of foods are by their very nature, as "allergens", detrimental to some consumers. This problem of a product being unavoidably unsafe for some consumers should, it is thought, be solved in the context of determining "defect" applying, *inter alia*, the "unreasonably dangerous" test, just as in the case of a manufactured product. It is suggested that this, if done, would almost invariably avoid liability for allergenic natural products (e.g. strawberries, milk, tomatoes) because their allergy potential is common knowledge.

38. Another aspect of natural products that may raise concern is the likelihood of their deterioration, which could occur at any stage between production and consumption. As this may be due to improper storage, unexpected delays in distribution or other factors beyond the producer's control, imposing liability on him might be thought inappropriate. However, obviously rotten or stale food is unlikely to be consumed and, if it is, the defences of lack of "latent danger" or "assumption of risk" would help to avoid liability. Even the other cases of harm caused by deterioration would only entail liability if the product were already "defective" at the time of circulation by the producer or other person potentially liable.

39. Furthermore, if under the scheme liability would be channelled to the importer, two further objections would become less forceful. One is the difficulty in identifying the individual producer because natural produce is often bulked. The other is the concern that strict liability (or the attendant insurance costs) would constitute

a crushing burden on the "small neighbourhood greengrocer".

40. Above all, not only are "defects" in natural products much less frequent than in manufactured goods, they also are typically the result of some kind of human fault (e.g. including foreign objects in food, such as stones in rice, bees in honey). Even with regard to the seemingly exceptional case where environmental conditions rather than the producer is to blame (e.g. fish from waters not known at the time to be polluted), liability could nonetheless be justified in the interest of equal treatment with other producers and on the theory of risk-spreading as well as in recognition of the profit-making goal of the enterprise.[17]

Products related to subjects of separate liability schemes

41. Some types of products could be excluded from the uniform scheme because they are covered by, or related to, subjects of separate, specific liability schemes, often in international conventions, or because their inclusion might infringe upon the purposes of one or other such scheme. Thus, for example, nuclear materials and all parts installed in nuclear reactors or similar facilities should be excluded in that they generally are the subject of special regulatory schemes, both national and international, recognizing their extraordinary risk potential.[18] A similar consideration would seem to apply to aircraft and ships, including their component parts.

D. *Persons in whose favour liability is imposed*

Possible restriction of plaintiffs under strict liability

42. The next problem in identifying the elements and scope of liability is to determine the range of persons who may claim compensation. As the replies of Governments to the questionnaire indicate, recovery under fault systems is not generally limited to certain categories of plaintiffs;[19] it is merely restricted by some legal requirement concerning the connexion between the negligent act and the injury or damage suffered, e.g. that there be "proximate", "direct", or "adequate" causation, that the harm be "foreseeable", "within the risk", or "contemplated by the rule", and so on.[20]

43. In strict liability, one could either follow this familiar path, possibly with some refinement, or allow recovery only to certain classes of plaintiffs, because liability irrespective of fault to all potential victims could be regarded as too extensive. Resolution of this question should reflect the general policy considerations justifying products liability as well as the goals of unification. For this reason, it is proposed in the ensuing paragraphs to consider the case for protection of each of the categories of possible plaintiffs.

Last buyer

44. The last buyer (or one, such as a hirer, standing in a similar contract position) does not present a difficult case. If he suffers damage while using or consuming the product himself, few would deny his standing to recover. Even where he does not use or consume the product, his position *qua* "buyer" would justify compensation for any recoverable damage which he can persuade the court he has suffered. From a policy standpoint this situation should not be viewed as directly flowing from the contract because a contractual right would merely exist against the other party to the contract, the immediate seller, who might not be the person liable under the proposed uniform scheme. It should rather be seen as a consequence of the fact that the buyer chooses the product in reliance on its safety and, above all, contributes via purchase price to the "buyers' mutual benefit fund" discussed above.[21]

45. There may be some doubts with regard to the buyer's damage from products bought for commercial, industrial or professional use.[22] Those cases where commercial use means resale (or similar distribution) will be discussed later in the context of recoverable loss (see below, sect. E, paras. 62-63), because, there, the damage suffered by the last purchaser consists usually in pure economic loss. As to products used by the last buyer for industrial or professional purposes, their exclusion, which might be favoured by advocates of consumer protection who have only private users or consumers in mind, can be supported on a number of grounds.

46. Firstly, the rationale of consumer ignorance and reliance seems far less applicable to professional users whose adequate knowledge of product characteristics may rightly be assumed. Furthermore, it is not unusual for such buyers, with their stronger bargaining position as compared with private consumers, to be able to influence the risk level by, for example, insisting on certain specifications. Thirdly, to the extent the damage is caused by mechanical products such as machines or tools, the underlying explanation may be misuse, poor maintenance, or disregard of instructions.[23] Finally, protection via third-party liability seems, at any rate, less needful because first-party insurance is more easily available for business risks and because the loss in question may already be covered by a workmen's compensation scheme.

47. Against the foregoing position, however, are the following considerations. Though the arguments advanced above may be valid to some extent, they do not appear to command the kind of weight that should, it is suggested, be required in order to justify detraction from the desirable goal of comprehensive unification by the exclusion of a considerable portion of the goods involved in international trade. Secondly, to the extent the arguments are valid, a proper response could probably be found within the system to accommodate such cases. For example, the issues of the plaintiff's expert

[17] There may even be an element of deterrence because the producer is at least nearer to the source of the danger and thus to information about it than the ultimate consumer.

[18] Thus, for example, Vienna Convention on Civil Liability for Nuclear Damage, 1963, article II, 5.

[19] Analysis, sect. II, B, 1, Q.5, para. 1.

[20] As to such rules delimiting liability, see Analysis, sect. II, B, 1, Q. 6, paras. 16-19.

[21] Part I, C, above.

[22] See, for example, Geneviève Viney, "L'application du droit commun . . .", *loc. cit.*, p. 94.

[23] See, for example, Leon Green, "Should the manufacturer of general products be liable without negligence", *Tennessee Law Review*, vol. 24 (1957), p. 93.

knowledge of the product's characteristics or of misuse of the product by him or his employees could be dealt with in the context of determining the "unreasonably dangerous condition" of the product or by recognizing appropriate defences.[24] Other specific circumstances of business use could be taken into account also by allowing the commercial buyer's supplier to insert clauses in their contract limiting the buyer's right of recovery, which would appear to be a better solution than general exclusion of commercial use from the scheme.[25]

Consumer or user

48. The next, somewhat broader, category to be considered is comprised of the persons actually consuming or using the product. While most of them would also be buyers, recovery should not, however, be based on any narrow contractual notion, such as theories of warranty. As already argued above (see part II, paras. 9, 10), contracting and non-contracting consumers or users should be treated alike, in view particularly of the fact that it is often a matter of chance who will be injured by the defective product.

49. Consumers and users, as such, deserve protection because they rely on the safeness of the product, which itself is intended for the very purpose of consumption or use, and because they are, besides being the targets of production and distribution, the beneficiaries of the policy of risk control and harm prevention. These policy considerations should, it is suggested, justify recovery even by those not contributing to the "buyers' mutual benefit fund". This result may further be supported by the consideration that such consumers or users are usually in some kind of family, social or business relationship with the buyer who, thus, can be assumed to pay his contribution for their benefit as well.

50. Following the foregoing rationale for recovery, the terms "consumer" and "user" should then be construed in a very broad sense so that "consumer", for example, would include a person who does not in fact consume the product but prepares it for consumption by someone else, and "user" would also cover anyone who passively enjoys the benefit of a product, e.g. car passenger.[26] Even such extensive interpretation of a rule favouring users and consumers would, however, still leave out some potential victims, whose case for protection will be discussed next.

Non-user in sphere of risk ("innocent bystander")

51. Under a strict liability scheme it may be disputed whether compensation should be awarded to persons other than users or consumers, e.g. pedestrian hit by car with defective brakes. Even in the United States where strict liability has been most widely adopted there is far from uniform agreement on the issue: the American Law Institute in its Restatement of Torts issues a caveat, expressing no opinion on the matter; and the courts remain divided on the issue, though with a clear trend in favour of extending liability.[27] Both European texts favour recovery, it appears, since recovery is not limited to certain classes of plaintiffs.[28]

52. Recovery by a non-user in the sphere of risk, who is commonly labelled the "innocent bystander", may be opposed on the simple ground that the injured bystander is neither a buyer nor a user or consumer of the product. As one authority has said of him, "he has relied upon nothing, he is not the kind of person the defendant has been seeking to reach, no representation has been made to him expressly or impliedly, he has done nothing except to be there when the accident happened".[29] Such reasoning, however, seems to focus entirely on the consumer reliance rationale, ignoring the theories of enterprise liability and risk distribution, under both of which no valid distinction seems possible between the bystander and the user. To let bystanders benefit from the buyer's contributions may also be supported on the ground that buyers profit from the use or consumption of the product and thereby, though innocently, endanger others.

53. Another reason for extending strict liability to innocent bystanders is the policy of deterrence, the desire to minimize the risk of personal injury, which is valid for all potential victims regardless of status. It has even been suggested in this connexion that greater protection should be extended to the bystander than to the user in that "the bystander is even worse off than the user—to the point of total exclusion from any opportunity either to choose manufacturers or retailers or to detect defects".[30]

54. If strict liability were thus also imposed in favour of persons not using or consuming the product, the consequence would be that, as with negligence liability, the range of plaintiffs would not be categorically restricted to certain groups. The resulting co-extensiveness with negligence liability could, perhaps, be supported by the argument that strict liability with its notion of the product being "not duly safe" is close to fault liability, at least where negligence is presumed. This in turn raises the question whether it would not be appropriate in that case to recognize a general restriction to "persons [whom] the defendant should expect to be endangered by the probable use of the product, as in a negligence case".[31]

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[24] See, for example, Fleming James, "General Products—should manufacturers be liable without negligence?", *Tennessee Law Review*, vol. 24 (1957), p. 927.

[25] This problem is further discussed below, paras. 81-82.

[26] See, for example, William L. Prosser, "Products liability in perspective", *Gonzaga Law Review*, vol. 5 (1970), p. 168; *Restatement of the Law (Second), Torts*, vol. 2 (St. Paul, Minn., American Law Institute Publishers, 1965), comment 1 to sect. 402 A, p. 354.

[27] See, for example, 63 *American Jurisprudence 2d*, Products liability (New York, Lawyers Co-operative Publishing Co., San Francisco, Bancroft-Whitney Co., 1972), sect. 144; Dix W. Noel, "Defective Products: extension of strict liability to bystanders", *Tennessee Law Review*, vol. 38 (1970), pp. 4, 13; Comment, "Products liability—New York adopts rule protecting bystanders—strict liability in tort v. breach of warranty", *New York Law Forum*, vol. 19 (1974), p. 888.

[28] European Convention on Products Liability in regard to Personal Injury and Death, article 3, as explained in Explanatory Report, Council of Europe document CCJ (76) 41 add. IV, para. 53; Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 1, as explained in Explanatory Memorandum, in *Bulletin of the European Communities*, 1976, Supplement 11, p. 14.

[29] William L. Prosser, "Products liability in perspective", *Gonzaga Law Review*, vol. 5 (1970), p. 170.

[30] *Codling v. Paglia*, 298 N.E. 2d 622 (New York, 1973), p. 624.

[31] Dix W. Noel, "Defective Products: extension of strict liability to bystanders", *Tennessee Law Review*, vol. 38 (1970), p. 12.

E. *Heads of damage and consequential damages covered*

Bodily injury and death

55. There will be little dispute about covering bodily injury and death because life and limb are commonly regarded as the archetype of interests deserving of protection. Difficulties with this category of protected interests concern rather the extent of compensation, the recoverable types of damage, and, particularly in case of death, the persons entitled to sue.

56. According to the general indemnity principle of compensation (*"restitutio in integrum"*), the plaintiff should without doubt be compensated for the cost of medical treatment and, perhaps less clearly, for loss of earnings. Admittedly, medical costs and salary levels vary considerably from one country to another, but even within a country the defendant typically "has to take his victims and the doctors as he finds them", and regional differences become less relevant if liability is channelled to the first domestic distributor.

57. The next problem, whether persons beyond the one who is actually injured should be entitled to sue, is most acute in death cases. Some legal systems allow recovery for loss of support or service to all persons who were in fact supported by the deceased, others only to those who were legally entitled to the support, and yet others merely to certain, named dependants.[32] It would have to be decided whether one of these alternatives, preferably the first, should be adopted, or whether this matter should be left to national law, because unification seems difficult and not really necessary, at least from the point of view of the impact on insurability and insurance costs.

58. It would, however, appear preferable to deal expressly with the following two matters in a uniform scheme. First, consideration might be given to disallowing the award of punitive damages, which are only known in some systems and even there have been deemed objectionable in the field of products liability.[33] Secondly, consideration might be given to allowing compensation for "pain and suffering", including loss of enjoyment of life. Recovery for such non-pecuniary loss has sometimes been rejected on the ground that damages here are too hard to measure and the idea itself perhaps even offensive. But such loss, it may be countered, is "real", too, and from the point of view of calculability not more difficult than some other kinds of recoverable loss which the law nevertheless attempts to quantify.[34]

Damage to property (other than product itself)

59. Tangible property is commonly protected under liability systems based on fault.[35] Its inclusion in a strict liability scheme may, however, seem objectionable. In general, damage to property does not seem to call for recovery in the same way bodily injury does although, for example, a farmer might well consider the loss of his crop or livestock a greater loss than, say, a broken arm. Another factor at work here is possibly the fear that the risk exposure in property damage cases may be too extensive in that it may entail large financial losses (e.g. loss of profit after factory fire). Furthermore, it has been observed that in the context of property damage, insurance taken out by the property owner (first-party insurance) is superior in terms of practical efficiency and of economy of operation than third-party liability insurance taken out by the would-be defendant.[36]

60. The foregoing reasoning, however, is most telling in the case of commercial or professional users for whom property damage is just another form of economic loss. Private users do not ordinarily take out first-party insurance for property damage, except perhaps for such major items as a house, car, boat, etc.; and their loss, usually small in comparison, may affect them very considerably (e.g. loss of shelter). Thus, one might follow the suggestion of one commentator, as incorporated into the European Communities' proposed directive, to allow recovery only for "damage to or destruction of any item of property other than the defective article itself where the item of property is of a type ordinarily acquired for private use or consumption and was not acquired or used by the claimant for the purpose of his trade, business or profession".[37]

61. Even if the foregoing proposal were not accepted, and damage to commercial property were included, one should, it is suggested, exclude damage to the defective article itself, for whether a defective part of it causes damage to the product itself or whether the article simply fails to work, the cause for complaint is the same, and so is the person suffering damage, i.e. the buyer.[38] Thus, compensation may be properly left in this case to the law of sale.

Pure economic loss

62. Pure economic loss means financial loss standing alone and not consequential to personal injury or property damage. It appears in various forms, some of which may call for different solutions: for example, expenses may be incurred for repairs or recalls of products with detected defects; loss of profit may result from product failure; sellers may have to compensate unsatisfied buyers and may suffer additional loss of business if word spreads about the defective product.

63. The various causes of economic loss and the relevant policy questions would have to be discussed in detail if serious consideration were being given to extending uniform liability to such loss. Such a prospect seems, however, unlikely, for even under present fault schemes purely economic interests, such as expectations of

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[32] See, for example, Harvey McGregor, *Personal Injury and Death*, in International Encyclopedia of Comparative Law, vol. XI, chap. 9 (Tübingen, J. C. B. Mohr), pp. 90-96, and Analysis, sect. II, B, 1, Q.5, para. 3 and Q.6, paras. 5-7.

[33] Thus, for example, Bert M. Thompson, "Products liability—a company view", *Federation of Insurance Counsel*, vol. 23 (1972), pp. 7-8.

[34] See, for example, Sally Robins, "Developments in absolute and no-fault liability in products cases: The cents and nonsense of no-fault", *American Bar Association—Section of Insurance, Negligence and Compensation Law, Proceedings 1971*, p. 486.

[35] Analysis, sect. II, B, 1, Q.6, paras. 9, 10.

[36] J. A. Jolowicz, "Product liability and property damage", working document No. 7, Commission of the European Communities, Directorate-General for internal market, Directorate Approximation of laws: companies and firms, public contracts, intellectual property, fair competition, general matters (XI/359/75-E), p. 4.

[37] Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 6; J. A. Jolowicz, "Product liability . . .", *op. cit.*, p. 8.

[38] See, for example, J. A. Jolowicz, "Product liability . . .", *op. cit.*, pp. 2-3.

financial advantage or the interest in not incurring out-of-pocket expenses, are rarely protected. At any rate, it may be felt that the contractual remedy is sufficient and appropriate in most of these cases, which seem to concern unmerchantability rather than active malfunctioning of the product.

F. *Defences (and burden of proof)*

64. Some preliminary points may be made in discussing the subject of defences. Firstly, there are a number of special pleas by which the defendant's liability exposure may be limited or extinguished. Two of these —a ceiling on the maximum amount recoverable, and barring by expiry of the prescription (limitation) period —are discussed later in the report (see G and H, below). Secondly, there are a number of general defences to a tort (or delict) action such as "voluntary assumption of risk", *force majeure*, contributory (or comparative) negligence, intervening act of third person recognized in most systems, which may exclude or reduce a defendant's liability in particular circumstances.[39] These have been adequately set out in a previous report[40] and it does not seem necessary to restate them here in detail. Thirdly, it should be observed that the concern here is with a defence in the strict sense of a counter-attack raising an additional point and not a "defence" in the sense merely of denying an essential element of the plaintiff's case.[41]

65. It would not be feasible to attempt a discussion in detail of the subject of defences at this point, since much would depend on the decision as to the basis of liability and the detailed conditions thereof. All that can be done at this stage is to indicate a number of possibilities. If liability were based on negligence, the traditional defences such as voluntary assumption of risk, contributory (or comparative) negligence, and faulty intervention by third party would presumably remain.

66. These same defences could also be admitted in a strict liability scheme, subject to certain qualifications. Thus, for example, the defence of assumption of risk may be allowed in cases where the plaintiff fully recognizes the danger and voluntarily consents to the risk. Similarly, contributory (or comparative) negligence could be a defence in cases of obvious defects in the product, but preferably "not in case of an objectively negligent failure to discover the defect in a product or to guard against the possibility of its existence".[42] Lastly, negligent acts by third persons could be dealt with by recognizing a specific defence in those terms or simply under the general rules of causation.

67. There are, apart from the foregoing, certain possible defences which are peculiarly relevant in the context of strict liability. Firstly, if strict liability were adopted but development and system risks were not covered, one would then have to provide for the specific defence that the product was made in conformity with and reflected the state-of-the-art in science or technology; other defences become relevant, if, on the other hand, these cases are not left out. Similarly, in order to preclude or to limit liability in cases of misuse or abnormal use of products, it would be necessary either to define "defective" in terms of fitness for "normal" or "foreseeable" use[43] or expressly to recognize in the uniform scheme a suitably worded defence for such cases.

68. The burden of proof, i.e. the onus of establishing the facts and the risk of non-persuasion, lies usually with the party favoured by the rule or requirement at issue. But it should also matter in whose sphere the doubtful circumstance falls. Thus, for example, the plaintiff could be required to prove that his damage was caused during normal use of the product by an unsafe condition of a type which typically or probably exists at the time of circulation. The defendant could then rebut that, establish non-existence of the defect when the product left his hands, or show that the condition was not "unreasonably" dangerous.

G. *Maximum amounts as absolute limits*

Purpose and alleged benefit of absolute limit

69. According to a widely held opinion, strict liability, being a departure from the recognized fault principle, should be accompanied by a maximum limit. This idea of a trade-off of one thing for the other seems, however, to be purely a matter of history, and recent history, for that matter, considering the situation in pre-negligence days. The matter should, in principle, be decided strictly on its own merits.

70. The main reasons stated in favour of absolute limits are to provide certainty and to avoid crushing liability on defendants. Proponents of maximum limits have usually had catastrophe exposure in mind, with reference especially to the insurance consequences.[44] Detailed consideration of maximum limits from the insurance perspective will be made in the special part of the report devoted to insurance questions. Suffice it to note here that catastrophe exposure is not unique to strict liability but quite possible under a fault system, too. It may also be recalled that only in very few cases does strict liability for defects amount to liability without any actual fault.

Possible methods and inherent problems

71. Even if agreement were reached in principle on setting absolute liability limits, the difficulties in finding a suitable method could well prove insurmountable. There are basically two ways of setting liability limits which could be considered as alternatives or used in combination. One is to establish a ceiling per claimant per occurrence. Although such a rule has the advantage that it would be easy to administer, it could be unfair to victims, unless the ceiling were fixed at a very high level. On the other hand, if the ceiling were fixed at a fairly high level, it could lose much of its limiting effect except with regard to a relatively small category of defendants

[39] See Analysis, sect. II, B, 1, Q.7, paras. 2-10.

[40] A/CN.9/103, paras. 76-82.

[41] An example of the first (pure) kind of defence would be the plea of contributory negligence in a negligence suit and of the second, a plea that the defendant could by no means have avoided the unsafe condition of his product, i.e. a denial that the defendant was negligent.

[42] Dix W. Noel, "Defective products: Abnormal use, contributory negligence, and assumption of risk", *Vanderbilt Law Review*, vol. 25 (1972), pp. 128-129.

[43] Cf. similar suggestions concerning the definition of "defective", para. 39.

[44] See, for example, A. V. Alexander, "The law of tort and non-physical loss: insurance aspects", *Journal of the Society of Public Teachers of Law*, vol. 12 (1972), pp. 120-121.

(such as producers of products with a potential to cause serious injury, should an accident occur, which injury would normally have called for compensation exceeding the per claimant limit). Furthermore, a limit of this sort may not be very meaningful in the case of mass-produced products where a single defect could affect a whole series of products, thereby causing a huge aggregate exposure for the producer, even with application of the per claimant ceiling. At any rate, as later noted in the part on insurance, it does not appear significantly to affect calculability of exposure or insurability.

72. The other method is to limit the aggregate liability of every defendant per defined period (e.g. one year) for one type of product or for all his products.[45] Apart from the insurance aspects, there are some inherent problems in this approach which deserve due consideration. First of all, it seems difficult to find appropriate maximum amounts that would differentiate in an acceptable way between big and small enterprises, on the one hand, and between various categories of products, on the other. Furthermore, if only one limit were set for all, it would have no actual limiting effect on many defendants who tend anyway to get insurance coverage only up to the point they and their insurers feel is their actual exposure. Thirdly, a uniform maximum limit might seem unfair in that it would tend merely to ease the burden of some defendants; and, fourthly it could cause great administrative problems when claims are brought in various different courts and jurisdictions and the maximum amount has to be distributed amongst many claimants.

73. In the light of these difficulties, which admittedly would be less serious if liability were channelled to the importer, it is perhaps helpful to note that there may be a practical alternative to a maximum limit in the case of a catastrophe. This is that the Government of the State concerned, where appropriate, could step in and provide support, as it would in other cases of disaster and emergency. One might well conclude that the issue of maximum monetary limits to liability is one which, in the context particularly of unification on a global level, calls for further analysis and consideration.

H. *Prescription (limitation) period*

Limitation period for particular plaintiffs

74. It would seem appropriate to set time-limits for bringing compensation claims, in order to give defendants (and their insurers) more certainty about liability exposure and to exclude litigation after a long period of time has expired and relevant evidence become hard to come by. One possible limit is a subjective period for each particular plaintiff. This would have the advantage of getting information early to the defendant, who then could take steps to prevent further damage. The period could run from the time when the product was acquired by the last purchaser or, preferably, when the plaintiff became (or should have become) aware of the damage, or when he became (or should have become) aware of the damage and the defect, or, it has been suggested, when he became (or should have become) aware of the damage, the defect and the identity of the defendant.

Period for circulated product

75. Calculability of exposure and insurability may further be enhanced by setting an objective period of limitation which would commence with the circulation of the product by the defendant and close at a fixed time some years after.

76. Despite the variety of products which would be covered by the scheme, it should be possible to agree on one such objective period for all. It is true that there are some products, such as machines and tools, intended to be used for a long time, much longer than consumer items such as children's shoes, for example. However, as mentioned earlier, malfunctioning by such products may often be attributable to poor maintenance, misuse or disregard of instructions; these factors, and the fact that one is considering the commercial context where parties generally are able to look out for their own interests, might justify a period of limitation shorter than the normal life expectancy of such products in order to reduce the problems of proof. If thus a relatively short period were chosen, there would be less need for the other, subjective, period of limitation, although both periods could be accommodated in a uniform liability scheme.

I. *Relationship of uniform scheme to other liability rules*

Relationship to laws concerning extra-contractual liability

77. In view of the main goals of the present unification effort, the uniform scheme should, with respect to compensation, replace the extra-contractual liability rules because, otherwise, certainty and equality would not be achieved. Such exclusivity should obviously be restricted to matters falling within the scope of the scheme; matters not governed by the scheme would, of course, remain subject to the law otherwise applicable. This might, for example, be the case with topics such as economic loss, property damage, or certain kinds of products if these were left out of the uniform scheme.

78. Another possible exception may be made in cases where special liability laws already exist under national law for specific products; here, however, one could require that the protection accorded the claimant be no less than he is accorded under the scheme. As regards statutes regulating safety standards or similar provisions, there is no real conflict because they would be applied in determining "defect" or "unreasonably dangerous condition" under the uniform scheme. It would then be up to the courts to decide whether compliance with such regulations was conclusive evidence of the lack of a "defect" or whether those regulations should be treated merely as minimum requirements.

[45] A similar approach, though without a limitation per defined period, has been adopted in both European texts. Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 7, limits the total liability of the producer for all personal injuries caused by identical articles having the same defect to 25 million European units of account (EUA), for damage to movable property to 15,000 EUA and to immovable property to 50,000 EUA; European Convention on Products Liability in regard to Personal Injury and Death, annex, allows States to reserve the right to limit the amount of compensation to not less than the sum in national currency corresponding to 70,000 special drawing rights (SDRs) for each deceased or injured person and to 10 million SDRs for all damage caused by identical products having the same defect.

Relationship to contract rules

79. If the uniform scheme were to replace existing extra-contractual liability rules, one might then consider applying the same principle of exclusivity to contractual compensation rules because, firstly, the dividing line between contractual and extra-contractual compensation rules is not easily drawn and, secondly, because it is drawn differently in various systems. Above all, the purpose of unification cuts across, and does not correspond with, traditional subject-matter boundaries of law but looks at the actual liability exposure whatever its origin. In view of the differences between private and commercial use, one could at any event consider exclusively in the case at least of private buyers.

80. Such exclusivity, once again, would be limited to the scope of the uniform scheme. This means, firstly, that it would cover only the compensation aspects of a case, leaving to contracts law such other contractual issues as the rights of avoidance of the contract or of price reduction. Secondly, it would be restricted to injuries and consequential damages caused by the active malfunctioning of the product ("materialisation of the danger of the defective product"), thus leaving out such matters as the consequences of the frustration of the plaintiff's expectations and unmerchantability or unfitness for some purpose of the product.

Validity of clauses excluding or limiting uniform liability

81. Even if none of the foregoing suggestions as to exclusivity were adopted, one must still face the question whether liability under the scheme could be effectively excluded or limited by exemption or disclaimer clauses. In general, such "contracting out" would adversely affect the goals of unification, particularly those of certainty and equal consumer protection.

82. Turning to particular application of the concept of exclusivity, one might possibly make an exception in the case of professional or commercial buyers, who have an interest in modelling compensation rights according to their own needs. However, private buyers (and consumers) should possibly be protected, at least where personal injury or death is involved. This exclusivity principle should, furthermore, be expressly stated in the uniform rules, but should not, however, be construed to limit or foreclose the possibility of factual disclaimers in the form of warnings or instructions which are taken into account in the determination of the question whether or not the product was in an "unreasonably dangerous" state and in the adjudication of the defences of misuse and of comparative negligence.

PART IV. INSURANCE ASPECTS OF PRODUCTS LIABILITY SCHEME

1. This part of the report will, as requested in the decision taken by the Commission at its eighth session,[1] examine the relationship between the subject of products liability and schemes of insurance which have been or may be developed in relation thereto.

2. With regard to personal injury and economic loss associated therewith, suffered as a result of accidents involving products, two different schemes of insurance, both of which are relevant to the present discussion, may be distinguished: third-party liability insurance provided by commercial (private or State owned) enterprises and publicly operated compensation schemes managed more or less on insurance principles and providing benefits typically on a first-party basis. In many countries the two kinds of insurance schemes coexist side by side while in others only one or the other exists or is relevant. It is typically to third party liability insurance that people refer when they express concern about the effect of products liability on insurance costs, since it is realized that the publicly operated compensation schemes (national health insurance) are often determined by different policy considerations (e.g., emphasis on compensating the victim regardless of whether or not there is someone on whom to impose liability, public subsidizing of the programme, etc.). It is, therefore, to third party liability insurance that the ensuing discussion will be devoted. The survey will be in two segments. The first will attempt to describe the current practice relating to third party products liability insurance, while the second will be devoted to a somewhat detailed consideration from an insurance perspective of some of the key features envisaged for a uniform liability scheme.

A. *Current coverage practices relating to products liability insurance*

The coverage described

3. Products liability insurance or, as it is better known in the trade, "products hazard coverage", essentially is coverage designed to protect the producer/distributor of a product against third party civil liability claims for injury to person or damage to property allegedly caused by such product. In modern practice, the insurer in providing this coverage undertakes to (*a*) defend the insured in any suit brought against him the basis of which is the risk insured, and (*b*) pay on behalf of the insured such sums, if any, as he may become legally obligated to pay as damages resulting from such suit.[2]

4. In practice products liability insurance may be written either as a specifically identified coverage within a general business liability policy or as a separate policy. In either case it is important to note that products hazard coverage is increasingly viewed in the insurance market as a coverage separate and distinct from any other liability insurance, whether general or specific, which the business might carry, and one thus which must be specifically purchased. In short, it is common to view this coverage as having characteristics and features

[1] See above, introduction, para. 1.

[2] See generally on this subject Roger C. Henderson, "Insurance protection for products liability and completed operations —what every lawyer should know", *Nebraska Law Review*, vol. 50 (1971), p. 415; Howard C. Sorensen, "The new comprehensive general liability policy's products liability coverage", *Insurance Law Journal*, 1966, p. 645; Howard C. Sorensen, "What a lawyer ought to know about products liability insurance coverage", *Trial Lawyer's Guide*, 1968, p. 322; Jean Bigot, "L'assurance de la responsabilité civile des fabricants pour les produits livrés", in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, Aix-Marseille, Faculté de Droit et de Science Politique, 1974, p. 213; Jean Bigot, "L'assurance de la responsabilité civile des fabricants", in *La responsabilité des fabricants et distributeurs*, Recherches Panthéon-Sorbonne (Université de Paris I, Paris, Economica, 1975), p. 157.

of its own which, as far as the insurer intends, are not reproduced by any other coverage.[3]

The coverage distinguished from related coverages

5. To understand better the function of the products hazard coverage it is necessary to place it in the over-all context of business insurance by examining its relationship to other business coverages. Perhaps the most distinguishing feature of this coverage is the fact that it operates only as regards products over which the manufacturer or distributor has relinquished control, has passed on by sale or otherwise to others. Thus it is usually an explicit or implicit requirement of such coverage that the accident on which a claim is based occur (*a*) after the insured has relinquished possession of the product, and (*b*) away from the insured's premises. It is this fact that in the ordinary case the risks contemplated are those materializing after delivery of the goods that distinguishes the products hazard coverage from a "premises and operations" coverage, which businesses generally also carry.[4] The latter coverage, much the older of the two kinds of coverage, insures the businessmen essentially against liability to third parties resulting from accidents occurring on the insured's premises and accidents occurring during production.[5]

6. Another business insurance coverage which it is necessary to refer to in this context, not only because of its importance in business risk management but, more significantly, because of its close relationship to products hazard coverage, is the "completed operations coverage".[6] So closely related are these two coverages that it often is impossible in certain cases to decide as between them which coverage is applicable, and which not. For understanding, it is best simply to consider the completed operations coverage as a "service counterpart" to the products hazard coverage, which, like the latter, protects against liability for accidents occurring away from the insured's premises but which, unlike the latter, operates with respect to a service which the insured has performed regardless of whether or not a defective product also is involved. Thus this insurance would cover liability incurred as a result of work performed by the insured retailer at the owner's home on, say a television set from which a fire and subsequent injury arose, even if the material used in the work was not defective and the allegation, was, for example, the insured's negligent performance of the job in question. If however, the injury or damage were caused by a defective product used in such performance, then the loss could just as easily fall within the provisions of either the products hazard coverage or the completed operations coverage, or both.[7]

Excluded losses

7. A feature of products hazard coverage that it may be of some importance to refer to is the category of exclusions, the various kinds of risk expressly excluded from coverage under a products liability policy. One such exclusion which sometimes is written into the policy is the so-called "business risk" exclusion. This clause attempts in effect to exclude from coverage, often in circumstances not too clearly defined, loss attributable to errors in the planning or design of a product.[8] A simple example would be an insured manufacturer of fertilizer who puts out a new kind using a novel chemical combination which turns out to be too rich in nutrients, causing mutations in crops and heavy losses to farmers. The insurer might then in such a case seek to avoid coverage, pleading the "business risk" exclusion. The rationale for the exclusion is that the intent of the products hazard coverage is to cover defects arising at the production stage but not those attributable to management decisions at the planning stage, on the ground, it has been argued, that the latter is merely a "business risk", much like making a poor investment decision the disappointments of which should be compensable, if at all, only by a special form of insurance.

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[3] This state of affairs no dobut reflects the growing importance of the subject of products liability as a distinct topic within the general realm of torts. Significantly in a number of jurisdictions where hitherto it had been customary for, say, a manufacturer to take out but one general liability policy to cover his tort exposure, doubts have arisen, as products liability law has developed, as to whether such policies are sufficient in themselves to provide complete products hazard coverage, and insurers consequently have felt the need to develop specific products liability clauses which the insured may add to his general policy. Such appears to be the case, for example, in the Federal Republic of Germany. See on this the report by W. Rosener and E. Jahn in *Product Liability in Europe* (Deventer, Kluwer, 1975), pp. 80-81.

[4] This point is well brought out in the insurance practice of French-speaking countries where the products hazard policy is specifically referred to as *"police de la responsabilité civile après livraison"* or *"police R.C. produits livrés"*. Cf. the products hazard endorsement commonly used in the United States which states that an accident arising out of the use of the insured's product is covered "if the accident occurs after the insured has relinquished possession thereof to others and away from premises owned, rented or controlled by the insured".

[5] Cf. the "police R.C. exploitations" in French insurance practice. Until late developments in products liability law in many countries suggested the need for products hazard coverage, "premises and operations" coverage was apt to be the only liability coverage carried by businessmen for their extra-contractual exposure.

[6] In France, *"L'assurance R.C. après travaux"*. See Jean Bigot, "L'assurance de la responsabilité civile des fabricants", *loc. cit.*, p. 163.

[7] This dichotomy between products hazard coverage and completed operations coverage which exists in some insurance markets is by no means a necessary one as is evident from the considerable overlap which exists between the two coverages. In the United States, for instance, prior to 1966 the risks contemplated by the two coverages were insured under one coverage, then called "products hazard (including completed operations)" coverage and became separated only because of certain problems of legal interpretation that had arisen. It is important, however, to note this separateness, where it exists, because a business in order to be fully covered for accidents arising out of the manufacture or distribution of products may well find that it needs to take out both coverages.

[8] An example of such a provision is that found in the products hazard and completed operations portions of the Comprehensive General Liability Policy in general use in the United States, which excludes: "bodily injury or property damage resulting from the failure of the named insured's products or work completed by or for the named insured to perform the function or serve the purpose intended by the named insured, if such failure is due to a mistake or deficiency in any design, formula, plan, specifications, advertising material or printed instructions prepared or developed by any insured; but this exclusion does not apply to bodily injury or property damage resulting from the active malfunctioning of such products or work."

Leaving aside the much disputed question of the effect of the proviso at the end, one notes that many different kinds of risk are covered by the wording of this exclusion clause. Not only, for example, does the exclusion cover risk of loss from misleading instructions on how to use the product, but it seems also to cover what are usually termed "development and system risks", that is, loss arising from the exhibition by the product of harmful effects which having regard to the state of knowledge at the time of its production were not, or could not be, foreseen or, being foreseen, could not be avoided.

8. The standard products hazard and the completed operations coverages also exclude several other heads of risk which are worth mentioning here. One is damage to the product itself. Thus, for instance, if because of an internal electrical defect in machinery sold by the insured, the entire factory in which such machinery is housed is destroyed by fire, the products hazard coverage would cover the cost of rebuilding the factory but ordinarily not that of replacing the machinery itself. Also not compensable under this coverage is damage consisting simply in the fact of the buyer having lost his bargain by receiving defective goods, even though the loss to the insured may be quite substantial as when, to take an example, he has to rebuild or replace defective machinery. In short, the coverage contemplated here is for tortious or "extra-contractual", rather than contractual, liability.[9]

9. A related and increasingly important category of non-compensable damage is economic loss which the insured or anyone else incurs in withdrawing defective products from the market. Recent instances in many countries of massive recall from the market of hundreds of thousands of products—cars, electrical goods, toys, food, drugs, etc.—by their manufacturers well show how substantial a cost may be involved in this step.[10]

Limits of coverage

10. The two matters to be considered next relate to the limits of the products liability coverage with regard to both space and time, that is to say, territoriality and duration. As to territoriality, the first question is, what, if any, are the geographical limits within which it is contemplated that the policy will be effective to provide coverage against third party liability? One should perhaps start by noting that most products liability policies are written by domestic insurers on domestic businesses which do little or no business outside of the particular country in which both insured and insurer are located. Consequently, the standard products liability policy will generally limit coverage to claims arising within a particular country or group of countries.

11. Other reasons for this situation relate to the capacity, both legal and factual, of insurers to provide multiterritorial coverage. Thus an insurance company may conceivably be precluded by its charter or articles of incorporation or by the law of its domicile from insuring risks other than those which it is contemplated would materialize, if at all, only in a given territory. Furthermore, even without such legal limitations a great many companies have neither the capacity to service extra-territorial or multiterritorial risks nor the expertise about local conditions elsewhere to want to venture into such risks. As a result one finds that in every insurance market the number of companies which write multiterritorial policies, especially when world-wide coverage is contemplated, is usually fairly small. These companies tend to be the larger ones, some of which actually specialize in international risk insurance. It is, therefore, to such companies that a business entity would turn for coverage for its export business.

12. Even given the desire by the insured for such coverage and the capacity of the insurer to provide it, there often are other obstacles to the maintenance of a single products liability policy that covers every territory into which the insured's products are imported. It is not unknown, for example, for the law of the place into which the products are to be imported to require the importers involved to maintain insurance with a local insurer;[11] if such an importer happens to be a direct subsidiary, affiliate or agent of the producer's the effect may be the same as requiring the producer to maintain such insurance as a condition of doing business in the jurisdiction in question. Often, too, the insured for reasons of his own may wish to have different insurers insuring him in different territories.

13. What results in practice, therefore, is a rather variegated picture in terms of territoriality provisions in products liability policies.[12] As far as the company with a significant export business is concerned, the main interest of this report, there thus are basically two options: to take out with an insurer able to furnish it a single policy with the appropriate territoriality endorsement; or to take out with a local insurer a policy in and for each territory or group of territories in which it is interested. The latter route is apparently the one more commonly taken by companies large enough to have substantial overseas operations.[13] Where this route is taken, it also is quite common for the insured, in addition to such individual policies providing primary coverage, to maintain a single "umbrella" policy with a world-wide coverage endorsement for liability in excess of that provided by the primary policies.

14. The second question with regard to territoriality is the effect, if any, which territorial considerations may have on the premiums which the insured has to pay. While it is not possible to say for certain that the territorial limit factor has no effect on rates, it seems nevertheless to be the case that the role which this factor

[9] See, for example, the relevant provision of the Danish Standard Public (Commercial including Products) Liability Policy, reproduced in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, Aix-Marseille, Faculté de Droit et de Science Politique, 1974, p. 123.

[10] Incidentally, this item of damage is excluded from coverage even though the policy may contain at the same time a provision obligating the insured to take all reasonable steps to prevent further injury or damage from arising from the same or similar causes, which provision evidently contemplates actions such as recall of defective products. In some markets, however, the practice is for the insurer to share such costs with the insured. Cf. Danish policy cited in preceding note.

[11] Such a requirement is more often aimed at strengthening the local insurance industry than at ensuring the financial accountability of the insurer to local judgement creditors though, of course, it has a favourable effect on the latter as well. One example is Brazil, which, it would seem, requires all importers to maintain their transportation insurance with a local insurance company. See "Insurance in developing countries, Developments in 1973-1974", Study by the UNCTAD secretariat TD/B.C.122/Supp.1 (1975), para. 76.

[12] The provisions themselves take many forms: there may be an express clause limiting coverage to a defined territory, a clause excluding certain territories from the operation of the coverage, an express endorsement for world-wide coverage, and far less common, though not unknown, omission of any reference to territorial limitations creating at least a theoretical argument in favour of territorially unrestricted coverage.

[13] Inquiry reveals this to be the case among United States companies, for example. It should be added that these questions only arise where the exporter has decided to take a general liability coverage for such business. It sometimes is the case that the exporter carries no such insurance, except as may be contractually agreed upon with a buyer with respect to a specific transaction, and relies instead on a previously worked out general indemnification arrangement with its distributor in the importing country which ordinarily is the defendant in product liability cases.

plays in rate-making or in the calculation of individual premiums is relatively small, perhaps insignificant. First of all, except where special local conditions call for a separate rate structure for a particular market, products liability rates are normally constructed to yield a single uniform rate per product or product classification regardless of territory. Individual premiums are then arrived at simply by applying the rate to the unit of exposure (sales volume or receipts) exhibited by the insured business.

15. This situation stems presumably from the fact that the loss-producing characteristics of a product are by and large inherent to it—there must be a defect—and thus have very little to do with the place of use: the defect with consequent injury could have manifested itself anywhere. The fortuitous fact of occurrence in one place rather than another is seen, therefore, to afford no rational basis for territorial rate classifications. Also inappropriate, it would seem, is a territorial classification based on place of origin or production of a product, for once again, unless there are definite characteristics associated with producers in each particular territory, such a classification would be of little use as an indicator of the relative loss propensity of the products encompassed within the classes or of the producers concerned.

16. Indeed, it would seem that only with regard to loss-severity (i.e. the size of a judgement award or other settlement) might differences exist as between territories significant enough to justify rate distinctions. This is because the size of awards reflects a number of factors that often vary from society to society: the general cost, as well as standard, of living, social attitudes towards personal injury and towards defendants, consumerism, etc. However, the trouble of constructing a rate structure that would reflect such differences may make the effort not worth while. Besides, to the extent that the insurer and the insured are both operating in the context of an industrialized society, the chances are good that the rates, being based on conditions there, would be at a level at least as high as (if not higher than) they would have been if based on conditions in, say, a foreign market in a less industrialized country; consequently the insurer in such a case would stand to lose nothing by using his ordinary rates on a world-wide or multiterritorial basis.

17. The conclusion that emerges from the foregoing consideration of the role of territorial limits in products liability insurance appears to be, therefore, that its most crucial role is at the stage at which the underwriter decides whether or not to provide coverage on the terms desired by the insured, that is, to include certain territories within the coverage area contemplated by the policy. Once the decision is made to give such coverage, there is likely to be no great effect on rates. The underwriter, in other words, attempts to control his loss and, just as important, his ability to predict it, by keeping coverage within familiar territory rather than extending coverage to the unfamiliar but at a rate designed to offset the perceived disadvantages of such a move.

18. As to the other limit to coverage, its duration, no single uniform practice seems to exist.[14] Often the policy is written on a 12-monthly basis. This means from the insured's point of view that the cost of his insurance is guaranteed for one year and that the policy too is immune from cancellation—except for such serious acts of non-performance by him as non-payment of premiums; it means on the insurer's side that he has the opportunity every 12 months to reassess the insurance both in terms of continuing coverage and of price level. It is not unusual, however, to find policies of longer duration (three to five years, for example). Such policies often are used for the larger cases and usually con • n either a premium adjustment provision enabling the insurer to revise the premium annually, if required, or, in some countries, a "retrospective premium adjustment" provision under which, contrary to the ordinary practice of quoting one rate prospectively which stands regardless of experience during the policy period, the parties agree that if the loss experience during the policy period is better than expected the premium will be adjusted downward up to a certain minimum and if worse adjusted upwards up to a specified maximum.

B. *Products liability insurance rating*[15]

19. The crucial importance of the subject of insurance costs to any products liability scheme warrants a brief survey of the pricing process in products liability insurance.

Rate-making techniques

20. Two rate-making techniques will be examined: the "pure premium" method and the "loss-ratio" method. The following preliminary remarks might be found useful in this connexion. Firstly, one might note that within the insurance company it is the function of the actuary to set the rates for the various lines of insurance that the company may offer. Since the essential object of insurance is to compensate those as yet unidentifiable members of a group who will suffer pecuniary loss out

[14] Not dealt with here is the otherwise complex legal question of the relationship between the duration of the insurance coverage and the act to which the damage is traceable, whether, that is, coverage exists, for example, only with respect to acts done during the policy period or only to injury or damage suffered during the policy period, or to both. See on this Jean Bigot, "L'assurance de la responsabilité civile des fabricants", *loc. cit.*, pp. 193-198.

[15] This account of the rate-making process in products liability insurance is based primarily on information gathered with respect to the pricing process in the United States insurance market. The reasons for basing the account on the practice in one insurance market are, firstly, that the theory of insurance rate-making itself based largely on the statistical theory of probability, purports in principle to be valid regardless of the insurance market involved, although local differences may exist in the actual actuarial techniques employed. Secondly, given this fact and the fact that one's interest is simply to discover how rates actually are constructed, with the specific objective of determining the role, if any, played in that process by changes in the rules of legal liability, it seemed most profitable to examine this question in a single well-defined context. The choice of which insurance market to use was determined by the fact that, except for the few works cited below, which mostly deal with the United States situation, very scant literature is discoverable on this specific topic; thus it has been possible to obtain some of the requisite information only through direct interviews with people in the insurance business, those in New York being the most accessible. Specific reference was made to the following works: C. A. Kulp and J. W. Hall, *Casualty Insurance*, 4th ed. (New York, Ronald Press, 1968); C. A. Kulp, "The rate-making process in property and casualty insurance—goals, techniques, and limits", *Law and Contemporary Problems*, vol. 15 (1950), p. 493; Morris, "Enterprise liability and the actuarial process—the insignificance of foresight", *Yale Law Journal*, vol. 70 (1961), p. 554; McCreight, "The actuarial impact of products liability insurance upon choice of law analysis", *Insurance Law Journal*, 1972, pp. 335-352.

of a pool of funds previously contributed by all members of the group, the actuary has two main goals in performing his task. His first and primary goal is to produce rates which will be adequate to cover the expected losses during the period in view; secondarily, he wants to the extent feasible to produce a rate structure which is equitable in distributing the cost of insurance among the group of insureds based on their individual loss-producing characteristics.

21. Secondly, there are a number of terms which will be encountered in discussing this topic. The first is "unit of exposure". This is the concept used by the insurance actuary to measure and express the cost of protecting against losses from the covered risks. It is as such simply a counting device for measuring the quantitative extent of the hazard, enabling the price to be expressed in terms of a fixed concept. In the case of products liability insurance, for example, the unit of exposure may be expressed in terms of say, each $1,000 of sales of the product in question. By "rate" of insurance may be understood the price of such insurance per unit of exposure. Applying the rate to the number of units of exposure generated by a particular insured's business yields the "premium" (i.e. the total price) which that particular business must pay for the insurance in question.[16]

22. In order to devise rates which will yield adequate revenue to meet the anticipated losses, the actuary must first attempt to predict the aggregate quantum of such losses. This he does by resort to the law of averages. From this he knows that, given a large enough group, the over-all incidence of loss-causing events on that group will tend not to vary by much from one period to another, though its distribution within the group will. Consequently, his aim is to be able, by studying the past claims experience data of the group over a defined period, commonly a three-year period, to predict what the claims experience of the group as a whole will be over an equivalent prospective period. He "assumes", in other words, "that the immediate future will be much like the recent past. Last year's plaintiff will not be injured again next year, but someone much like him may well be."[17]

23. Since this actuarial assumption underlying rate-making is valid only for large aggregates, the actuary must try to work with such aggregates. In many cases, where a large enough enterprise is involved, it is possible for the actuary to have adequate data just from consideration of one individual enterprise's experience. In that case such enterprise will usually be individually rated based on its own loss experience. For most insureds, however, it is not possible because of their small size to generate reliable ("credible" is the more exact actuarial term) experience data. Consequently the actuary creates broad rate classifications in which risks are grouped on the basis of selected common loss-producing characteristics. His aim is to make each such grouping large enough to permit the drawing of valid statistical conclusions and yet homogeneous enough to permit the rate for such group to reflect the loss-producing characteristics peculiar to that group. It is to each of these broad groups thus that the actuary applies his comprehensive statistical analysis and from his calculations is able to project the future losses of the group and thus to compute a rate for the group which he expects would cover such losses.

24. In arriving at a final rate figure the actuary considers not only the past statistical history of the group concerned, but, to a lesser extent, also any other factors which to him are likely to have an effect on the size or frequency of loss. Such factors may be economic (e.g. inflation), legal (e.g. administratively enforced safety regulations) or even intangibles such as changing social attitudes to a particular activity. The extent to which these factors, which are called "trends", influence the end-result may vary from actuary to actuary since even as regards economic trends, which are relatively quantifiable, there is still an element of judgement involved in assessing them—much more so with regard to the others. Often, however, the problem is avoided in practice by applying to the rate a pre-computed rate factor used in common by insurance companies.[18]

25. In addition to the portion of the rate which is devoted to meeting anticipated losses and which often is referred to as the "underlying pure premium", and when expressed as a percentage of the rate as the "loss ratio", there are two other components of the rate. One of these is the expense factor, that is, the amount needed to defray the necessary cost of providing and administering the insurance (taxes, agents' commission, overhead, etc.). This component is often also, like the pure premium component, the product of statistical analysis and projection. Finally there is a portion representing anticipated profit, into which also is built a factor for error called a "contingency margin".

26. Under the "loss ratio" method, which is often used by actuaries when it is either not desirable or not feasible to undertake the creation of a wholly new rate-structure, the actuary starts off with an idea as to what the desirable or necessary loss ratio should be (loss ratio being, as noted, the percentage of the rate taken up in the payment of losses). He then analyses the existing rate structure and paid claims to determine what the incurred loss ratio has actually been in the relevant period. By comparing the incurred loss ratio with the desired loss ratio, he is able to determine algebraically what rate level, given the anticipated losses, would be needed to produce the desired loss ratio. He then adjusts the existing rate level upward or downward as may be required.

Relevant underwriting factors

27. The rate having thus been established for each category of risk, responsibility passes from the actuary to another insurance professional, the underwriter. It is the latter who, taking into account the exposure characteristics of a particular applicant for insurance, decides whether or not such applicant is an acceptable risk and, if he is acceptable, into what rate category he belongs

[16] To illustrate, in the case of products liability insurance, the annual premium for a business which grosses $5 million from sales of a particular product with respect to which it is seeking liability coverage would, assuming a rate, let us say, of $3 per unit of exposure (a unit being $1,000 of sales) come to 3(5,000,000/1,000) or $15,000.

[17] Morris, "Enterprise Liability . . . ", *loc. cit.*, p. 560.

[18] In many countries products liability rates, like many other rates, are promulgated for insurance companies by a common rating organization (rating bureaus) to which most of them subscribe and to whose published rates they generally adhere. These manual rates are, however, often not used for the really large cases where the individual experience data are sufficiently credible to warrant individual rating.

and what his actual premium should be given the applicable rate.

28. It may perhaps be helpful to an understanding of the subject of insurance costs in the context of products liability coverage to note some of the factors which the underwriter uses to make his decision whether to underwrite a particular risk and at what level of premium and under what conditions. Such factors include: type of product, end use, whether used directly by consumer or by other producer, other potential uses; product design, history, claim experience, useful life of product; expected future claim experience (frequency, severity); product claim exposure from earlier years (product still in use after many years); annual sales; management attitude and history, commitment to safety and loss prevention; advertising and warranty claims made with regard to the product; size of exposure and insurer's ability to offset exposure with reinsurance; other lines of coverage maintained by the applicant; type of insurance plan desired, coverage limits, deductibles, etc.[19]

Summary of rate determinants

29. The principal object in exploring the rate-making process was, by increasing understanding of that process, to throw some light on the matter of insurance costs, more specifically the relationship between such costs and the prevailing rules of products liability. This question of whether, and if so to what extent, a stricter régime of liability necessarily entails significantly higher insurance costs is of obvious importance to an assessment of the desirability and feasibility of any scheme of liability for products involved in international trade. While detailed discussion of the question will be made later in this part, it is nevertheless instructive to note the following points emerging from the foregoing account of the insurance rate-making process: that the principal determinant of rate levels is the past loss experience over a period of time of the group or the individual, as may be applicable; that the actuary is interested in knowing, if he can, the aggregate losses he can expect with respect to a given class of insureds over a defined period and, furthermore, is primarily interested in over-all trends rather than in specific isolated losses, no matter their size; that factors such as stricter rules of liability appear to have very little direct effect on rates except to the extent they have become translated into a trend of actual losses; that for most insureds, for whom the manual or group rate is used, the effect of individual losses can become very much diluted in the pool of over-all group experience.

C. *Insurance implications of channelling*

30. The matters to be discussed next are the insurance implications of some of the key features suggested for possible inclusion in a uniform liability scheme. The approach will be to consider what obstacles, if any, to the implementation of each such feature are presented by the theory and practice of insurance. The questions to be addressed, specifically, are, first, whether a given feature of the scheme could make the liability thus imposed "uninsurable", and, secondly, what the cost consequences of such a feature might be in terms of products liability insurance premium.

[19] See, for example, *Product Liability Insurance*, Report of the United States Department of Commerce (Washington, 1976), pp. 34-35.

Cost consequences of channelling

31. Taking first the general question of the cost effect of channelling liability exclusively to one defendant (be it importer or producer), it seems apparent that this should produce net savings in the over-all cost of insurance viewed from the standpoint of the consumers of the products involved who ultimately must bear such costs. This would be so at any rate in those jurisdictions where more than one potential defendant is recognized in products liability cases. The savings should come in the lower administrative costs of providing coverage under one policy administered by one insurance company in place of the present situation in which each of the potential defendants in the chain of distribution of a product carries a separate policy administered by his own insurance company. There should also be real savings resulting from the elimination of the overlapping coverages that now exist in situations where more than one defendant may be sued and someone low in the distribution chain (e.g. the retailer) carries his own insurance even though he is also covered by the policy maintained by someone higher up (e.g. the manufacturer).[20]

32. Another way of looking at the matter is this: even though all or any one of a number of persons involved in distributing a product may be subject to the risk of being sued, the realities often are that in practice only one of them (e.g. the retailer) gets sued regularly, with the result that the insurers of the other potential defendants continue to collect premiums without paying out much by way of claims. Reducing the choice of potential defendants to one by channelling (and, as previously suggested, excluding duplicating rights under national law) should in most cases eliminate the need for the others to maintain coverage resulting, one might expect, in a not-insignificant reduction in the over-all cost of providing for the compensation of victims of defective products.[21] The potential for savings is appreciated even more when one realizes that under the present situation where more than one potential defendant is recognized, the insurer in contemplating the exposure of each such defendant acts usually on the assumption that this particular insured would be subjected to a claim for the full amount of any loss, not just a pro-rated portion of it. Consequently, a relatively high policy limit would appear advisable in each case and the coverage presumably priced to reflect this assumed exposure.

33. There should also be some savings resulting from elimination of the causes of the subrogation disputes and litigation that commonly arise under the present

[20] One reason why this sort of situation may arise, apart from any excess of caution on the retailer's part, is because a business usually takes out a single products hazard insurance to cover all the products it handles, with the result that an overlap would exist with regard to any particular product whose manufacturer's insurance policy contains a "dealers coverage" endorsement extending that policy's protection to the retailer.

[21] How much savings will actually result is difficult to predict since the effect of channelling will also be to subject the one policy to all the claims that in theory at least used to be spread among a number of policies; nevertheless it seems to be the case that it is cheaper to provide coverage for an anticipated total loss in one policy than to provide a similar aggregate amount of coverage by a number of policies with lower limits. It is cheaper, that is to say, to provide for an anticipated $100,000 loss, for example, under one policy than to cover the same loss by 10 separate policies each with a $10,000 limit. Stated differently, the first dollar of coverage is more costly to buy than the ten thousandth.

state of affairs between the various insurance carriers involved as they try to establish among themselves which carrier should bear the ultimate responsibility for meeting a claim.

34. Channelling liability to one defendant alone would also have the favourable insurance consequence of enhancing loss predictability. Since all claims must be brought against the one defendant (i.e. against the one policy) the insurer has a much better idea of what the loss experience on that particular policy will be like. Greater loss predictability means a sounder and more reliable rate structure, which in turn usually means increased market capacity as more underwriters become willing to write such coverage. As with most market situations, the greater the number of underwriters willing to write a particular coverage, the less upward pressure there is on premiums and the more competitive the price quotes which the underwriters make in their bids for a particular contract. Channelling liability to one defendant should therefore have a beneficial effect on the availability of insurance ("supply") and on rate levels.

Channelling to importer

35. If the uniform scheme were to channel liability to the importer, this would make him the sole defendant in any claim based on the rules and, consequently, the one who normally would take out liability insurance in the first instance. There appears to be no reason why such a system could not be implemented from an insurance point of view. In many legal régimes currently existing the importer as such is not excluded from the category of possible defendants, other conditions of liability having been met. In such jurisdictions virtually anyone who has dealt with the goods or handled them in the course of trade be it producer, importer, wholesaler, distributor, or retailer is a potential defendant. The plaintiff still has, of course, the problem of showing, in a negligence régime, that he has been damaged by the negligence of the particular defendant he has picked, and in a strict liability régime, that this defendant distributed the particular product that caused him damage, but this all goes to a different question.

36. As it happens, it is not often that the importer, if he plays no further role in the distribution process than simply passing the goods on to others in the chain of distribution, is sued—not, at any rate, where he is made the only defendant. This is because in the majority of cases the criteria which the plaintiff would use in picking one defendant from a list of possible defendants would tend to point to entities other than the importer. However this may be, the important point for present purposes is to note that the importer is a familiar defendant and recognized potential defendant in many existing products liability régimes. Consequently, it is not unusual today for the importer under such régimes to carry products hazard coverage.

37. If, and to the extent this is so, a liability scheme which would make the importer the sole defendant would have introduced nothing new in terms of creating in the importer the need or the obligation to take out products liability insurance.[22] The only aspect that is new is the fact that the importer alone would have need to carry such insurance, but this relates to the question of possibly higher costs and the internal allocation of such costs among the parties involved in the production and distribution of the product and not to the question whether or not insurance would be available to the importer to offset the liability now channelled to him.

Possible insurance arrangement

38. Assuming then that it is feasible for the importer to be insured against the liability that he would bear under the proposed channelling scheme, the question may still be asked in assessing the channelling idea who, the importer or the producer, would from the insurance perspective be a preferred defendant. Which, in other words, would (from the point of view of cost and efficiency) be a better insurance scheme for a uniform product liability régime, one in which the producer himself took out the policy covering all his export business, or one in which individual importers took out local coverage?

39. No easy choice exists between these two approaches, for there is strong merit on both sides. Having the manufacturer take out the coverage may have the advantage of simplicity and perhaps economy. In place of the many individual policies that would be issued—one for each importer—by perhaps as many insurance companies and with possibly as many variations in actual policy provisions, one would have but the one policy for each producer-exporter, with resulting identity of coverage for all importers of the product wherever located. This would be particularly advantageous in a situation where there are several importers of the product for one country because, coverage being provided by the one policy for all the importers involved, it would then not be as crucial as it might otherwise have been for the injured plaintiff to be able to identify the particular importer of the specific product which has injured him. An additional consideration in favour of having the producer take out the coverage is that he himself would then be paying the premiums directly. This would not only permit risk spreading at the highest level, but would go some way towards meeting the objective of having the consequences of any defects in a product impinge directly on the producer of that product, thereby promoting greater product safety concern on his part.

40. Against this approach, and thus favouring the arrangement whereby the importer takes out the insurance, are the following considerations. First of all, as appears from the discussion above on the question of territoriality,[23] it may not always be feasible for the manufacturer to secure insurance effective in every territory where his product may cause injury or damage, especially where the liability to be covered is by law imposed on the local importer. Secondly, it may in fact be simpler for the importer to carry this coverage in many cases. This is because products hazard coverage, as was earlier noted, is most often furnished as part—albeit a distinct and separable part—of a general liability insurance. Hence, a business entity would be covered by that one policy for liability for all products which it handles as well as for other kinds of liability. In the context of the

[22] In many existing régimes, of course, the importer, not being a likely products liability defendant, does not, and has no need to, carry any products hazard insurance. The crucial question, however, is whether he could, if he needed to, obtain such coverage, and the answer to this is clearly in the affirmative.

[23] See paras. 10-17 above.

present discussion, therefore, an importer who imports several different products, all from different manufacturers, and who in addition handles domestically-produced goods would, if he took the insurance out himself, nevertheless have but one products hazard coverage to deal with. Thus current insurance practice would seem to favour the alternative whereby the importer in each country took out his own separate coverage.

41. Furthermore, it may not in every case lead to significant net savings in the over-all cost of the insurance to have but one policy taken out by the manufacturer covering all his business world-wide, since it is quite possible that any cost savings which would thus result might be largely offset by the administrative costs to the insurer of maintaining servicing capabilities in every jurisdiction where a suit is likely to be brought requiring intervention by the insurer. Individual policies adapted to local conditions and written by local insurers on each local importer might well turn out in some circumstances to cost less in the aggregate than one single world-wide policy covering all exports.

42. A related question is that of the fair allocation of the liability insurance costs among buyers of the product. If the coverage is taken out by the producer on a world-wide basis and he makes no allowance for variations in loss propensity between countries, which may come about because of, for example, differing rules of liability, larger awards in some countries than in others, etc., the result would be that buyers of the product in one country would to a greater or lesser extent be subsidizing those in other countries. One thinks particularly of the situation where the manufacturer does business in both States which have adopted the uniform rules and those which have not. Such a problem would, of course, not arise under the "importer insurance" alternative since *ex hypothesi* only one country is involved in every case. But, on the other hand, a different form of "unfairness" might arise, namely that the importer if he deals in more than one product (all of which are covered by the same policy) may not always be able to allocate the insurance costs equitably among such products, with the effect that consumers of "safe" products may be subsidizing buyers of the relatively "unsafe" ones.[24]

43. It thus appears that the considerations are evenly balanced with respect to choosing the better form of insurance arrangement as between the two approaches just reviewed, although if one had to state a preference one would on balance perhaps favour the arrangement which under current insurance practice seems easier of implementation, namely, the taking out of the insurance on a regional and local basis by the importer. The fact, however, is that insurance considerations by themselves do not in this case afford a sufficient basis for choice because of the considerable flexibility that insurance practice affords and the difficulty of forming solid conclusions on the cost consequences of the various alternatives. Thus, for example, even if liability were channelled to the importer, it would still be possible for the producer to take out a single coverage naming all of his importers as insureds,[25] if liability were on the other hand channelled to the producer, he could still take out coverage under individual local policies rather than a single global one.[26]

D. *Insurance implications of basis of liability*

Strict liability and insurance rates

44. The next issue to be considered is the effect which a change in the basis of liability (essentially from a fault idea to that of strict liability) might have on the cost of products liability insurance. Whether or not a relationship exists between rules of legal liability and liability insurance rates is quite clearly a complex question and one which can be answered definitively, if at all, only by means of a scientific survey of actual trends in legal liability and in insurance rates for a given jurisdiction or selected jurisdictions during a predetermined period. Unfortunately, the Secretariat knows of no such studies.[27] Nevertheless an attempt will be made in the ensuing paragraphs to evaluate this question in light of principle and the scant evidence available. Such evalua-

[24] In point of fact neither of these situations would be anything new. Exactly the same situation exists today when manufacturers sell to countries with differing régimes of products liability, and when importers, wholesalers and others take out coverage without differentiating in their prices the relative cost in terms of products liability premiums associated with each product. Furthermore, whether or not it makes any difference to the price paid ultimately by the consumer in a particular country at what point (at the producer or importer level) the insurance costs are spread, and if so, how much, depends on such factors as: the extent to which the producer charges each territory with the cost experience therein (e.g. by taking out individual local policies) or spreads such costs at a broader level, the extent to which the producer and the importer respectively absorb some of the insurance costs (by way of reduced profit) or pass them fully on to buyers and the extent to which the producer or the importer, as the case may be, is allowed to shift the loss back to the one whose "fault" caused the loss. By and large, though, spreading the risk at the local level would seem to favour those countries, mostly developing countries, where products liability actions appear to be less frequent and the damages award level comparatively lower.

[25] There might perhaps be a question here whether the producer had an "insurable interest" (i.e. something to protect) seeing that liability now rested on the importer. The "insurable interest" factor is, it is submitted, supplied by the fact that the producer would still stand to lose business reputation and goodwill, and hence sales, if a situation developed in which victims of product defect were not seen to be fairly compensated. The arrangement would be comparable to the "dealer clause" already familiar in a number of insurance markets under which the manufacturer names his distributors and retailers as insureds in his own products liability policy, thus providing them coverage at his own cost against possible liability for harm caused by his products which they have distributed. Such coverage, as noted above, often overlaps with coverage taken out by the distributor or retailer for himself. See Allan P. Gowan, "Products liability insurance—duplicate policies—concurrent coverage—industry recommendations—loading and unloading", *Insurance Counsel Journal*, 1959, pp. 411-414.

[26] Cf. the earlier discussion on territoriality, above paras. 10-13. Other variations are also possible and may even prove the more desirable depending on the situation. One such variant could be an arrangement whereby the importer to whom liability is channelled took out the insurance for himself but the premium was paid by the producer either directly or indirectly through reimbursement of the importer.

[27] The only attempts to study this question of which the Secretariat is aware are still currently under way in the United States where, in response to continuing outcries by the business world about the rising cost of products liability insurance, both the United States Department of Commerce and the insurance industry recently ordered separate studies on the question, the results of which are expected to be available shortly. The Commerce Department did, however, issue a preliminary report in which it cited stricter rules of liability as a contributory factor to rising insurance costs, though it acknowledged the absence of any hard data to support this contention. (*Product Liability Insurance*, Report of the United States Department of Commerce, Washington, 1976.)

tion is all the more pressing because the relationship between the adoption of stricter rules of liability and the incidence and severity of judgement awards against defendants is a question of undeniable importance in the assessment of the case for an international products liability régime and the rules of which such a régime might be composed, having regard especially to the possible impact on industrialization in many countries.[28]

45. It is perhaps helpful to approach this topic at two levels. Firstly, one would want to know the extent to which the adoption of stricter rules of liability produces higher or more frequent judgement awards against products liability defendants; secondly, one should consider what effect, if any, such awards if established to be more frequent or more severe have on insurance rates.

46. Quite apart from the question whether hard supporting evidence is available, it seems justified in principle to suppose that any change which dispenses with the need for a plaintiff to prove fault, and not just anyone's fault but this particular defendant's fault, currently the most elusive element in building a plantiff's case, cannot but lead to an increase in the number of cases brought as well as in the number won by the plaintiff. This is so if only because such a change would tend to tip the scale in favour of bringing an action in cases which hitherto had been considered doubtful of successful prosecution by plaintiffs' lawyers. In most jurisdictions such a change would leave but the elements of defect and damage attributable to it to be proved by the plaintiff.

47. Still, it is not the fact that the adoption of strict liability tends to generate more cases that is significant in the present context: what is significant is how much of an increase it will bring. The answer to this depends to a large measure on the state of the pre-existing law in the jurisdiction concerned. Thus it is logical to suppose that such a change will have more significance in a jurisdiction where the law as applied has remained more or less true to traditional negligence doctrine than in one where that doctrine as applied in the cases has become so whittled down as to be virtually indistinguishable in its effect from a strict liability régime. The latter, it is generally recognized, was the situation in many jurisdictions of the United States prior to their adoption of strict liability, with the result that many observers there have downplayed the significance of strict liability as such for the major increase in products liability cases noted in recent years.[29] The more important cause, it has been suggested, is perhaps not so much "legal" as it is "social-ideological", meaning by this the rise in consumer consciousness ("consumerism") which demands much higher standards of performance and safety from products and services and, furthermore, is not hesitant to back up these demands with lawsuits, which in turn are adjudicated by judges and juries more or less sympathetic to the same consumer protection philosophy.

48. The importance of this last factor of consumerism, especially the active variety encountered in the United States, on liability recoveries in general and products liability recoveries in particular should not be underrated. Quite often the complaint of defendants and their insurers in products liability cases relate not so much to the fact of the recovery as to its size; in other words, it is not strict liability itself, which goes merely to the condition, not the amount, of recovery, as what is perceived as the propensity of the judicial system to award "excessive" amounts in damages that under this view is to blame for the so-called "crisis" of products liability insurance. Under this view "excessive" awards, by which is included awards (such as for "pain and suffering" and similar general damages) that go beyond the simple aim of restoring the injured party to the position he was in before the loss, are to blame not only because the large amounts involved deplete insurance reserves, necessitating higher insurance rates, but also because they encourage potential plaintiffs and unscrupulous lawyers to gamble for a financial windfall with each and every wrong, real or imagined.[30]

49. This view that it is not so much the content of the rule of liability itself, whether one has a rule of strict liability or one based on fault, but the surrounding social climate which bears the most on the incidence and size of judgement awards against products liability defendants, and hence the aggregate loss borne by insurers, appears to be consistent with the fact, first of all, that the so-called products liability insurance crisis is most acute in the United States, and secondly, that the problem has in intensity kept pace with the growth of active consumerism.[31] Thus most jurisdictions of the United States had strict liability for injury caused by certain classes of products—e.g. food and beverages—for many years without there being observed any explosion in the num-

[28] Not surprisingly such hard evidence as there is comes primarily from the experience of the United States where the condition for a factual, rather than merely conjectural, evaluation exists, namely, the coexistence over a sufficiently long period of both strict products liability and insurance for the same. Furthermore, an analysis of the situation in the United States should be useful because that situation is usually cited by opponents of strict liability as the paradigm case of the costly consequences of introducing such a basis of liability.

[29] Cf. the earlier discussion of the similarity in effect of strict liability and negligence criteria as they may actually operate in practice (part II, paras. 47-50).

[30] This complaint is well stated in an article in the 5 July 1976 issue of *U.S. News and World Report*, at p. 100, in which the president of one of the larger insurance companies in the United States, commenting on the urge to sue and its effect on that country's reparations system, is quoted thus: "... Jury awards are often in excess of the amount necessary to restore the injured party to the position before the loss.... Too often now our courts seem to have become gambling places where people who have suffered a loss go to spin some wheel of fortune, expecting a windfall profit. The few who do win big only serve to inflate the expectations of all.... In the courts, much of the action is in the products area. Last year alone, 1 million product suits were filed: 1 for every 200 men, women and children in the country.... The cost of liability insurance has become a major part of business-operating expenses. Not long ago liability insurance accounted for 1 per cent of manufacturing costs. Today it accounts for as much as 10 per cent of the costs of some products. It would be unconscionable to limit the amount of compensatory damages paid to an injured party for such losses as property damages, lost income, and medical expenses. But there should be a limit to general damages for pain and suffering and mental anguish. There are [also] sound arguments in favour of limiting the amount that lawyers can collect under contingency-fee arrangements." (*Note by the Secretariat*: a "contingency fee" arrangement is one under which an attorney agrees to take a case on the contingency that if he loses he is paid nothing, but if he wins he gets a fraction, usually one third of the recovery.)

[31] This is not to say, of course, that there are no other factors at work here which may contribute to the situation in the United States: the growth, for example, in the number of kinds of products on the market (currently estimated by the United States Commerce Department at 11,000 for consumer products alone) and in the number of each kind being produced is no doubt a factor in the rise in products liability cases.

ber of cases. The latter has come only with the rise of consumerism as a social philosophy.

50. The importance of isolating just how much of the increase in the incidence and size of products liability judgements which admittedly has been observed in many strict liability jurisdictions is due to the change in the rule of liability *per se* and just how much to other factors becomes most pronounced when one considers the matter of insurance costs. Clearly, to the extent strict liability generates more cases and more awards it is bound to affect adversely the insurance rates, since the insurer must charge more in order to meet the anticipated higher aggregate claims and administrative, including defence, costs.

51. Yet the relationship between the rule of liability and insurance costs is by no means a simple or direct one. In the first place, as was seen from the discussion on rate-making,[32] the actuary rarely concerns himself with the rule of liability as such. To the extent legal factors feature in his thinking he is concerned with trends, that is, with the over-all milieu of which the rule of liability is but a part and, as has been suggested, a not predominant part: he does not separate the fact of strict liability from factors such as the urge to sue, the sympathetic disposition of courts to large awards, high attorney's fees and other defence costs, all of which factors may well coexist with a different rule of liability producing the same cost effect to him and which, more importantly, may vary from jurisdiction to jurisdiction.

52. Furthermore, the actuary perceives these influences on costs through the medium of past over-all loss statistics for the period in view without any examination of the individual cases, or any breakdown of them into strict liability-associated and negligence-associated cases, thereby precluding any possibility of asserting that the same result would not have been reached without strict liability even given the other factors. The point thus is that it is at least doubtful whether a change in the rule of liability alone, unaccompanied by the other loss-influencing factors discussed, would produce a change sufficient to make a difference to the actuary's calculations, and yet this reasoning is implicit in the view that would blame strict liability for any anticipated or actual increase in products liability insurance costs following its adoption.[33]

53. This view of the limited role of legal rules *per se* in the rate-making process (seen in the context at any rate of a difference between "strict" and "fault" liability) tends to be confirmed by the fact that although a sizable number of jurisdictions in the United States have adopted strict liability as opposed to the fault principle still held by the other jurisdictions, the insurance actuaries there have found no reason to change their practice of using essentially one rate structure for the whole country.[34] That they have continued this practice in the face of what seems to be the differing exposures of an insured in a strict liability state and one in a negligence state suggests strongly that there perhaps is not that much of a difference from the actuarial viewpoint between these two situations. Put differently, the actuary may well have concluded that relative to the other factors shared by all the jurisdictions concerned the legal rule of strict liability is by itself not that significant.[35]

Strict liability, safety measures and insurance costs

54. There is one other determinant of the behaviour of insurance rates which deserves discussion here. This is the insured's or the industry's product safety record. Sometimes the improvement in that record and thus the reduced prospect of an accident may be so significant that it offsets, and occasionally more than offsets, the effects of loss-producing factors such as an increased number of claims and unfavourable legal and economic trends. The net result could then be a stabilization or even a lowering of rates. A dramatic illustration of this has been noted with regard to aviation liability insurance premiums in the United States which in 1975, according to one commentator, were running well below what they had been five years previously in spite of major increases in loss-producing factors.[36] Likewise it may be supposed that if strict liability encourages producers and others who handle products to become more safety conscious, it may well lead in the long term to a stabilization or at least a slower rate of increase in products liability insurance rates.[37]

55. A related question which has sometimes been raised by way of an argument against strict liability is

[32] See paras. 20-24 above.

[33] There may, however, be a different point that is being made, namely, that these other factors seem invariably to coexist with, if not be generated by, strict liability. It seems evident, though, that there is no necessary cause and effect relationship between strict liability and these other factors. What is true, however, is that because strict liability has historically come about in most jurisdictions by judicial evolution rather than legislative fiat it has tended to come about only in a climate in which the other factors were already at work, which explains the historical coexistence of strict liability and these other factors but does not permit one to draw the inference that strict liability could not exist without them.

[34] The only exception to this is the New York metropolitan area which has traditionally been treated as a separate rate territory for this purpose, but not, it would seem, for reasons of strict liability since the practice pre-dates the adoption of strict liability by New York State and furthermore appears to be confined to New York City and its environs.

[35] Other considerations may also have inclined the actuary not to attempt a differentiated rate scheme for the various parts of the country (e.g. the administrative costs of creating separate rate structures) but it is hard to believe that these would be decisive if in fact sound actuarial practice calls for such differentiation, particularly since insurance rates to be used in a state have often to be reviewed or approved by the insurance authorities of that state who wish to ensure that the particular rate structure is both adequate and fair.

[36] See John V. Brennan, "No-fault insurance in aviation products and services—one insurer's viewpoint", *Journal of Air Law and Commerce*, vol. 41 (1975), pp. 239-240 (foot-notes omitted). The author, who, as Executive Vice-President of United States Aviation Underwriters, Inc., is himself an insurance man, makes the following observations: "General aviation aircraft owners and operators are able to purchase all the insurance they desire at rates that are approximately forty per cent of what they were five years ago. This is true in spite of the fact that during the same period there have been between 600 and 700 fatal accidents per year and between 1,300 and 1,400 fatalities per year .... Airline insurance rates are currently twenty-five to thirty-five per cent of the rates in effect five years ago. These favourable rates apply in spite of the fact that there were only 146 fatalities arising out of United States airline operations in 1970, whereas 1974 saw a record 467 fatalities."

[37] There is no doubt that the trend in many industrialized countries toward stricter products liability, especially where coupled with consumerism, has produced greater safety consciousness among producers, particularly of consumer goods. This is well exhibited in the many publicized recalls and withdrawals of defective and merely suspected items which now take place.

whether the substitution of strict liability for liability based on fault would not operate as a disincentive to the safety-conscious, as opposed to the sloppy, producer in the fact that, as the argument goes, the insurer who hitherto had drawn a distinction in terms of rate treatment between the two would now simply treat them the same on the ground that it no longer mattered from the point of view of potential liability whether the producer acted reasonably or not.[38]

56. It is perhaps possible that strict liability would have this effect of obliterating, from the point of view of the insurer, the distinction between the careful and the not-so-careful manufacturer. This would be difficult to understand, though, for even under that régime the insurer would still have sound actuarial reasons for making the distinction. In the first place, the best insurance practice seeks first and foremost the reduction and, if possible, elimination of accidents rather than the strengthening of the legal position of the insured defendant, for once an accident occurs there is always the chance that the insurer will have to pay either because he cannot legally resist or because the cost involved in resisting (in terms both of money and business image) may be unacceptable to him. Since, therefore, the careful manufacturer is by definition less apt to provoke an accident than his more sloppy counterpart, even though their respective legal positions may become identical once an accident has occurred, the insurer under a strict liability régime still has good reasons to favour the former in his rating practice. There is also the point that the insurer knows that though the fact of liability may be as easily established in the case of the careful manufacturer as in the case of the not-so-careful one, the actual amount of damages awarded by the court, especially under a régime employing jury trial, may very well differ in the two cases in reflection of the court's judgement as to the relative "fault" of the defendants.[39]

57. The foregoing discussion of the relationship between strict liability and insurance rates may be summarized as follows. There is good reason to expect that the adoption of strict liability would lead to some increase in the number of products liability cases that are brought and in the number which go against the defendant. How much of a difference this simple fact of a change in the legal rule would make would depend on the pre-existing legal situation and the over-all legal and social climate. As far as insurance rates are concerned, although in the long run the cumulative effect of the increase, however small, in the number of claims against insureds will begin to tell on rates, there is reason to believe that only a small part, if any, of any rate increase occurring in the period after adoption of strict liability is properly attributable to the fact of strict liability itself as distinguished from the effect of the other loss-generating factors which sometimes, though not necessarily, go with strict liability.

E. *Monetary limits, prescription and certain defences*

Insurance implications of monetary limits to liability

58. The next issue to be considered relates to limits of liability. More precisely, the question is whether it is desirable or perhaps even necessary from an insurance point of view to have a maximum limit to the defendant's potential liability and, if so, what form this should take. The two kinds of proposal most often mentioned in this connexion are a maximum over-all limit per defendant per year (or per other defined period) for each product or for all products, and a maximum limit per claimant with regard to each occurrence or related series of occurrences. A third position would combine the two and provide a limit per claimant with an over-all ceiling on the aggregate amount payable by each defendant.

59. With regard to the aggregate limit idea as distinguished from the per claimant concept, it has often been pointed out that it is essential for the insurer when he writes a policy to have an idea of his possible total exposure in order to be able to calculate his risk and the consequent premium due and that as a result it is essential to provide in a uniform scheme for a maximum limit to a defendant's liability. While this statement is substantially true, it does nevertheless call for elaboration and some refinement. There are several reasons why an insurer needs a maximum figure to work with. He needs it, firstly, for his actuarial calculations, including determination of premiums and the appropriate reserves[40] to maintain; secondly, he would need it if he should wish to reinsure the risk with another insurer; and, lastly, he may need it to ensure compliance with a common statutory provision in many jurisdictions which forbids an individual insurer to assume liability on any one risk in excess of a certain proportion of its surplus.[41]

60. It is not, however, essential, though it may be desirable for reasons soon to appear, that the limit be stated in the liability scheme itself, such legally established limits being after all the exception rather than the rule in the general law of civil liability. Insurance has operated in the civil liability area (including liability for tortious negligence) for years and continues to do so even though the insured's liability exposure is in principle unlimited.[42] What the insurer does in such a case, however, is to provide by contractual agreement with the insured for a maximum limit which is inserted in the policy and operates to delimit the insurer's liability on

[38] See, for example, *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 36.

[39] It is also true that prior to insuring the producer, the insurer reviews the producer's safety and quality control programme and uses this as one element in his decision whether or not to insure such a product and at what level of premiums. Incidentally this point is one argument against channelling liability to the importer rather than to the producer. Since the importer generally has little to do with the way the product is produced and so with its safe or dangerous condition, a distinction between importers on the basis of product safety certainly appears less meaningful. (Indeed such a distinction may not be feasible except where one is dealing with businesses each of which imports but one or two products.) In any case, the problem remains in the case of the importer that the insurance underwriter will have to wait till he can look at the actual safety records of the products concerned whereas with the manufacturer an *a priori* evaluation of the manufacturing process is possible.

[40] A "reserve" in its simplest signification is the technical term for the amount which the insurer puts aside (reserves) for the purpose of meeting claims on the insured risk.

[41] Quite apart from such legal prohibitions, it seems doubtful that an insurer as a prudent businessman would wish to risk his entire assets on a single contingency.

[42] Although, therefore, it has become the common practice in internationally established liability régimes, especially ones imposing liability on a basis stricter than fault, to insert into the scheme a maximum liability limit, there is nothing inevitable about this.

the policy. Should the proposed scheme thus be introduced without a maximum limit provision, the consequence would simply be that the pre-existing practice of contractually determined policy limits would continue to operate, with resulting variances, of course, in the limits chosen by the individual insureds.

61. The effect, therefore, from an insurance perspective of including a maximum limit provision in the liability scheme proposed would be that instead of every insured making his own estimate of the amount of coverage he needed to take out, he would have a figure to aim at, which, it is thought, should result in many insureds carrying coverage for or close to the amount of the maximum liability.[43] This would have the advantage of reducing under-coverage on the part of the businesses affected; it might possibly also have the effect of increasing the ordinary cost of doing business either because a particular business is then carrying more coverage than it really needs or simply is carrying adequate coverage where once it used to be undercovered from the point of view of its exposure.

62. The other kind of limit, as indicated, is the per claimant limit. As to this, it is often said that it has no functional value from the point of view of insurance calculability. This statement too requires some qualification. It is true that as compared with the aggregate limit device, the per claimant limit is of secondary, if not minimal, value in calculating potential exposure for the simple reason, of course, that it sets no limit to the total possible exposure. Yet, it is not altogether without significance for the insurer in that even if he does not know what the upper limit of liability is, he does know that no recovery in excess of a certain amount can be had by any one claimant. This means that if he can estimate the number of claims there might be in the relevant period, which he ordinarily tries to do anyway, he is able to have some idea of the total loss to expect. Thus even this represents an improvement in calculability from the current situation in most jurisdictions where the exposure is open-ended at both the single claimant and the total group level.

63. One final comment which may be made on limits relates to the level at which the aggregate limit is fixed. It obviously should not be fixed so low that there would not be enough funds even if the whole amount were used up to meet a reasonable number of claims arising from the insured's defective product. On the other hand, it ought not to be so high as to defeat its substantive objective of protecting the defendant from the possibility of catastrophic liability, that is, from aggregate claims beyond an order of magnitude that is considered reasonable or possible for him to bear, particularly with regard to claims arising out of one malfeasance or one act of bad judgement. Considerations of "insurability" come into play in this context in that high exposure amounts coupled with high risk may mean such heavy insurance costs as would make the difference between an "economic" and an "uneconomic" business venture. This would be particularly true of a young industry or enterprise, which often must embark on its period of growth, experimentation and learning on very meagre resources and thus could ill-afford high insurance costs.

64. Furthermore, if the exposure is not merely high but reaches the level of the catastrophic, the problem may shift from the simple one of high insurance costs to that of finding any insurer that would even accept the risk, for although the insurance market is able by reinsurance, joint underwriting and similar "pooling" devices to provide a sizable insuring capacity, that capacity is obviously not unlimited. Consequently an excessively high exposure, especially if coupled with the significant probability of loss occurrence which does exist for some products, may have the result of making it difficult for some businesses to find insurance or to find it for the full amount of the prescribed limit. In practice, however, the limit, and thus the potential exposure, would have to be set at a very high level indeed for this question even to arise if one had regard to global insurance capacity, as is evident from the high level of exposure in many risks that are routinely insured every day—nuclear hazards, aircraft and general aviation risks, factories, etc. The question assumes its greatest significance, therefore, only when one thinks of domestic and regional insurance capacity especially in the developing world.[44]

Prescription (limitation period) and insurance costs

65. The one aspect of prescription (limitation period) which calls for special notice in the context of insurance is the perennial problem of products liability insurance sometimes called the "long tail" factor. This refers to the situation under which insurers often find themselves paying claims arising out of products manufactured or injuries suffered before the current policy came into being because of the fact that products liability policies typically cover all damage occurring or substantiated during the policy period regardless of when the act or omission creating the injurious defect took place or, depending on the policy and subject to requirements relating to prompt notice of loss, the injury sustained.[45]

66. The problem is most noticeable in the case of capital equipment such as machinery and with respect to durable goods where it is not uncommon to have a large number of the products covered by the policy be 5, 10 and sometimes even 20 years old. This obviously poses many problems for the insurer. Apart from the higher propensity for generating loss which older products, made according to different standards and without benefit of current know-how, must exhibit, loss predictability itself is adversely affected. This is so because even if one could predict the frequency of accidents involving, say, a particular machine, the size of the claim settlement will depend on whether the claim arose this year or five years later when there will have occurred not only economic inflation but an inflation, too, in terms of

[43] This calls to mind, too, the possibility of requiring under the scheme that the defendant on whom liability is channelled maintain liability insurance of a specified level.

[44] Such a situation might, on the other hand, stimulate the development of the domestic insurance industry in those countries as well as give impetus to the sort of co-operation among them in the insurance sector that is contemplated by the 1974 General Assembly Declaration on the Establishment of a New International Economic Order. See, on this, the UNCTAD secretariat study cited at foot-note 11 above, especially para. 86 *et seq.*

[45] Cf. following provision of Danish policy: "This insurance covers liability for bodily injury and physical damage *substantiated* during the currency of this policy regardless of the date of any act or omission in which the liability for the occurrence has its origin" (emphasis added), reproduced in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, *op. cit.*, p. 124.

social expectations. Insureds too have the problem of keeping track of durable products sold many years ago in case new technology or experience reveals a safety hazard which they are either obligated to or wish themselves to remedy.

67. It is no wonder then that one of the factors persistently blamed by business and insurers for the rising cost of products liability insurance, in industrialized countries especially, is the "long tail" effect. Limitation of the period during which a claim may be brought in respect of a product (creating a sort of legal-liability-life-period for products) is therefore a key point in many industry and insurance group recommendations for reform of products liability law. Particularly is the need for this stressed if strict liability were to be admitted, for then the insured could not even show in defence lack of negligence in the manufacture of the aged product in question. The proposal in the earlier part of this report[46] to provide for the cut-off of all claims with regard to a product at some point after that product was first put into circulation should serve, therefore, to alleviate the concerns harboured by the business and insurance sectors in this regard.

Development and system risks

68. As pointed out in the earlier discussion of current insurance practice in the products liability field, products liability policies sometimes contain an exclusion which is intended to deny coverage for this kind of risk. Furthermore, even where the policy is silent on this point there is exclusion in fact in many jurisdictions in that the defendant is able to avoid liability by showing that the alleged defect occurred in spite of all reasonable precautions on his part or was one which according to the state of scientific knowledge then in existence was not or could not be known to be a defect, or, being known, could not be avoided. With no liability on the part of the insured, no question arises of a development risk exclusion.

69. There is thus great interest among producers (and their insurers), in the treatment that might be accorded "development risk" under the uniform scheme. One must ask then what the effect might be on "insurability" and insurance rates should the defence not be recognized, that is, should the defendant be liable although the product was produced in accordance with and met the highest scientific and technological standards then available.

70. There is evidence to suggest that such a development might tend in many insurance markets to limit the number of companies writing products liability insurance. As it is, insurers do not appear in general to show much enthusiasm for writing this coverage even with the exclusion and there is evidence, in the United States, for instance, of some withdrawal by insurers from this line of insurance and a growing reluctance by others to continue writing it.[47] Furthermore, it seems too that coverage for the kind of risk contemplated under the development risk exclusion would be similar to that currently provided under what is called an "errors and omissions" policy. This latter coverage, which typically is carried by engineers, research scientists and others likely to commit design errors, is, however, available only from an insurance market that is even more specialized and limited than the one from which products hazard coverage may be obtained, thus suggesting that fewer companies than at present might be willing to write products liability insurance that would include elements of what is now covered under the "errors and omissions" policy.

71. A similar conclusion is suggested with regard to insurance rates. Rates for what is now "errors and omissions" coverage are typically higher than those for products hazard coverages. Consequently coverage for an insured which would include features of the current products hazard coverage and the errors and omission coverage, whether issued in one policy or separately, might well be expected to cost more than the present products hazard coverage.

72. There are, on the other hand, certain considerations which tend to suggest a less severe impact on insurance from the proposed change than may at first sight appear. First of all, as far as is discoverable from case law and legal literature, instances of true development risk materializing appear fortunately to have been very few indeed, suggesting a very low frequency of loss for the insurer even should coverage exist. Secondly, not all products liability coverage is currently written with the development risk exclusion, and though this in itself may signify only the insurer's confidence that the insured would be able to avoid liability in such a situation (see para. 68 above) it does nevertheless indicate a certain acceptance by insurers of the possibility that they may have to cover such loss. What all this does, therefore, is to raise the question whether insurers truly foresee a major increase in loss frequency or severity should they now have to provide coverage for this risk or whether their current position on the issue derives more from tradition and an abundance of caution.

73. A third factor to take into account, at any event, is the inclusion of maximum limits in the scheme of liability contemplated. This should go a long way towards making insurers more receptive to the idea of providing coverage for development risk since the major factor underlying exclusion of such risk is, it may be supposed, the fear of huge or uncontrollable losses arising from a planning or design error which perforce infects every product produced under that plan or utilizing such design. Such loss potential would now be limited by the applicable maximum limit, becoming thereby in addition more predictable.

74. Should insurers decide, however, that it makes a lot of difference to the premium chargeable that the policy provides or does not provide coverage for development risk, then one would think it would be preferable to have that coverage provided by way of separate endorsement to be bought and paid for separately. This would allow the coverage to be bought by those insureds alone who need it and thus avoid foisting the extra cost of that coverage on the many insureds for whom there will be only the remotest likelihood of liability on this account: an insured who deals in writing paper, for example.

Conclusions

1. The analysis of replies to the questionnaire reveal the existence of considerable divergencies among legal

[46] See part III, paras. 75-76.

[47] This point is continually made in the business press of that country. Cf. *Product Liability Insurance*, Report of the United States Department of Commerce (Washington, 1976), espec. p. 36.

systems in respect of liability for damage caused by products. These divergencies pertain to important issues such as the legal basis of liability, the grounds of exemption from liability and the kinds of damage for which compensation is recoverable. Depending on which law is applicable and in which jurisdiction damages are sought, the question whether compensation can be obtained and to what extent, and from whom and under what circumstances, will thus often receive a different answer.

2. In the setting of the international movement of goods, where increasingly goods produced in one country are used or consumed in others, the disharmony in the law of products liability has resulted in uncertainty from the point of view of both the consumer or user and the producer.

3. The survey made in parts I to IV of this report would appear to indicate that the preparation of rules establishing a uniform liability scheme is feasible.

4. The Commission may wish to consider whether there are *prima facie* sufficient grounds that would justify a continuation of work on products liability.

5. Should the Commission conclude that a continuation of work on products liability is at this stage justified, it may wish to consider in what direction such work should proceed and indicate the issues which in its view need further study.

6. It is suggested that further work be concentrated on the preparation of a preliminary draft set of rules for a uniform liability scheme. This draft set, to be accompanied by explanatory notes, should envisage alternative solutions, particularly in respect of the legal basis of liability and the persons incurring liability. It is expected that, if work were organized in this way, it would show more clearly the feasibility of a particular scheme and facilitate the policy decision which the Commission may wish to take at a later stage of the work, namely whether the subject-matter is of sufficient importance in the context of international trade to justify the drawing up of uniform rules and, if so, what would be the appropriate type of instrument.

7. If the Commission should conclude that work towards the preparation of uniform rules should proceed, the Secretariat suggests that such work should be guided by the following considerations.

(*a*) The scheme should be inspired by the general policy considerations underlying the evolution of products liability law that were identified and evaluated in part I of this report.

(*b*) As to the legal basis of the scheme, for the reasons stated in part II of this report, the contract approach, including warranty, is not thought to constitute a suitable basis for a uniform liability scheme. The scheme should instead focus, by means of alternative sets of draft rules, on the following alternatives:

(i) The traditional negligence concept under which the burden of proving fault would be on the plaintiff;

(ii) The modified negligence concept under which negligence on the part of the defendant is presumed; in other words, under which the defendant has the burden of rebutting that presumption or proving absence of fault;

(iii) The strict liability concept, based on the defective, dangerous condition of the product. As has been suggested in part II of this report, except for development or system risks which call for special consideration, strict liability can be viewed as virtually similar to the concept of "presumed negligence" ((*b*) (ii) above).

(*c*) As to the persons incurring liability, it has been submitted in part III of this report that producers, including suppliers of component parts, and commercial distributors, could be regarded as potential defendants. However, a case has been made in favour of limiting the number of potential defendants so as to provide greater certainty as to who is liable and to avoid the pyramiding of insurance costs. Although the report reflects a preference for channelling liability to the importer ("the first national distributor"), it is suggested that further consideration should be given to the possibility of channelling liability to the producer, or to the importer and the producer, and that alternative sets of draft rules should reflect such possible options.

(*d*) The preliminary draft rules would also be concerned with such issues as the types of product covered by the scheme, the persons who could claim compensation, the interests to be protected, what damages are recoverable, defences available to the person liable, periods of limitation, maximum amounts, the scope of application of the uniform scheme and its relationship to other liability rules.

B. Report of the Secretary-General: analysis of the replies of Governments to the questionnaire on liability for damage caused by products (A/CN.9/139)*

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* 13 April 1977.

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INTRODUCTION

1. At its eighth session (1-17 April 1975), the United Nations Commission on International Trade Law considered a report of the Secretary-General entitled "Liability for damage caused by products intended for or involved in international trade" (A/CN.9/103; Yearbook . . . 1975, part two, V), and requested the Secretary-General to prepare a further report examining specific issues deemed relevant by it in connexion with the continuation of work on the subject. The Commission was of the view that the Secretariat should also consider the advisability of circulating a questionnaire designed to elicit information on relevant legal rules and case law, and also on governmental attitudes to the issues involved.*

2. For the purpose of preparing the further report requested by the Commission, the Secretariat circulated a questionnaire to Governments under cover of a note verbale dated 26 March 1976. This questionnaire is reproduced in part I of this document. The following 35 Governments had replied to the questionnaire as at 31 March 1977: Afghanistan, Australia, Austria, Barbados, Belgium, Benin, Botswana, Burundi, Byelorussian Soviet Socialist Republic, Canada, Chile, Cyprus, Denmark, Fiji, German Democratic Republic, Germany, Federal Republic of, Hungary, Ireland, Madagascar, Mauritius, Netherlands, Nicaragua, Norway, Pakistan, Philippines, Poland, Portugal, Romania, Senegal, Sierra Leone, Sweden, Turkey, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland and Venezuela.

These replies are analysed in the present document. The replies, which with their annexures comprise approximately 300 pages, are with the Secretariat and may be consulted by members of the Commission if they so desire.

3. In the analysis that follows, the replies have been considered under the three categories of "contractual liability", "extra-contractual liability" and "proposals for law reform". The division into contractual liability and extra-contractual liability was adopted both because it commands wide acceptance and because many replies adopted that division in setting forth the law. Within the category of extra-contractual liability, the area of delictual (tortious) liability was analysed separately because of its primary relevance to the subject under consideration.

4. The further report requested by the Commission referred to above which is entitled "Liability for damage caused by products involved in international trade" is contained in document A/CN.9/133 (reproduced in this volume, part two, IV, A).

I. QUESTIONNAIRE

Information is requested on the national law in respect of liability for damage caused by products. It would be appreciated if a full account is given of statutory law and case law. The information should include the rules of contractual liability, tortious liability, and any other kind of extra-contractual liability in this field.

The questions listed below are provided as guidelines indicating the issues which should be dealt with in the description of each type of liability. Neither the issues raised in the questions nor the examples, which are based on distinctions made in some legal systems, are intended to restrict the scope of the account of the law. Thus, comments or information on any further relevant issues would be appreciated. It would be of assistance if the account would indicate any recent trends in the development of the law and any project for law reform on the subject at issue.

List of issues

1. On what concepts is liability based?
   (E.g., express contractual promise; notion of implied warranty; principle of fault, particularly negligence; strict liability, based on defect in product)
2. What acts or omissions may entail liability?
   (E.g., failure or mistake in manufacturing process; faulty design; misrepresentation of condition concerning safety; failure to give proper warning or instruction; circulation of product in unsafe condition not discoverable at the time of circulation with existing scientific knowledge)
3. What persons may be liable?
   (E.g., producer or assembler of finished product; supplier of component parts; wholesaler, retailer; service contractor)
4. Does liability differ depending on the kind of products causing the damage?
   (E.g., special categories such as pharmaceutical products, food motor vehicles; movables/immovables; mass produced goods/goods individually manufactured; crude or processed raw materials; natural products, agricultural products)

* Yearbook . . . , 1975, part one, II, A, paras. 102 and 103.

5. What persons may be entitled to compensation?
   (E.g., buyer only; also third party in some way related to him; private user or consumer; commercial user or consumer; any injured person)
6. For what types of loss or damage can compensation be recovered?
   (E.g., death, physical injury; damage to property other than product itself; economic loss unconnected with physical injury or property damage; infringement of non-pecuniary interest, *"dommage moral"*)
7. What defences are available, and what is their effect?
   (E.g., assumption of risk; plaintiff's misconduct such as misuse of product; intervening act of third person; circumstances beyond human control, *"force majeure"*)
8. Are there fixed limits to liability?
   (E.g., maximum amounts per product, injury or year; periods of limitation and other time-limits)
9. In respect of what matters does the plaintiff have the burden of proof, and in respect of what matters does it rest on the defendant?

II. Analysis of replies

A. Contractual liability[1]

Question 1: On what concepts is liability based?
Question 2: What acts or omissions may entail liability?

1. The information given separately in reply to these two questions was interrelated, and is therefore analysed together.

Breach of contractual terms agreed to by the parties

2. The majority of States which replied noted that breach of agreed terms as to the quality or fitness of goods supplied entailed liability (Afghanistan, Australia, Barbados, Benin, Botswana, Burundi, Canada,[2] Cyprus, Denmark, Fiji, German Democratic Republic,[3] Germany, Federal Republic of, Ireland, Madagascar, Mauritius, Netherlands, Norway, Pakistan, Philippines, Poland (provided the terms were in writing), Portugal, Romania, Senegal, Sierra Leone, Sweden, United Kingdom of Great Britain and Northern Ireland, Venezuela). The nature of the act or omission entailing liability depended on the contents of the term agreed to. No distinctions were drawn under this basis of liability depending on the type of supply contract in question (e.g. sale, hire, exchange, etc.).

3. Canada, in respect of the province of Quebec, noted that a contractual clause excluding liability for breach of agreed terms as to quality or fitness was of no effect in the following cases:

(i) When the clause was against public order and morality;
(ii) When the breach of contract involved *faute lourde* or gross negligence;
(iii) In the case of fraud which was a cause of nullity of the contract and created liability for damages;
(iv) Where one party had induced the other to accept the exclusionary clause by false representations;
(v) Where the effect of the exclusionary clause would be impossibility to execute the fundamental obligations of the contract.

Breach of obligations imposed by law independently of agreement between the parties to a contract

(a) *Sale of goods*

4. The replies indicated that certain legal systems imposed special obligations in contracts for the sale of goods. Two predominant approaches were noted:

(i) *The imposition of implied terms as to fitness and merchantability modelled on the provisions of the Sale of Goods Act 1893 of the United Kingdom.*

5. Australia, Barbados, Canada (for provinces other than Quebec), Fiji, Ireland, Pakistan, Sierra Leone and the United Kingdom noted that the following terms were implied in a contract for the sale of goods:

(*a*) Where the buyer made known to the seller the particular purpose for which the goods were required, so as to show that the buyer relied on the seller's skill or judgement, and the goods were of a description which it was in the course of the seller's business to supply, there was an implied condition that the goods should be reasonably fit for such purpose.

(*b*) Where goods were bought by description from a seller who dealt in goods of that description (whether he was the manufacturer or producer or not) there was an implied condition that the goods should be of merchantable quality.

(*c*) An implied warranty or condition as to quality or fitness for a particular purpose might be annexed by the usage of the trade.

6. The act entailing liability was the breach of such an implied term.

7. Australia, Barbados, Canada (for provinces other than Quebec), Ireland, Pakistan and the United Kingdom also noted that, in order to establish liability, the buyer had only to prove a breach of such an implied term,

[1] The replies of the Byelorussian Soviet Socialist Republic and the Union of Soviet Socialist Republics were confined to extra-contractual liability. The reply of Turkey only indicated that the legislation of Turkey did not provide a special rule with regard to the civil liability of producers, but that producers incurred certain civil liabilities for defective products through the distributors of their goods. The reply of Hungary was mainly confined to extra-contractual liability.

[2] Information was given by Canada separately for the province of Quebec, which has a system of civil law in the field of products liability, and for its other provinces, which have systems based on the English common law. When Canada is cited without any restriction as to a province or provinces, the proposition for which the citation is made applies to all provinces.

[3] The information given in the reply of the German Democratic Republic related to the law on international economic contracts adopted by the Peoples Chamber of the German Democratic Republic on 5 February 1976. The law applies to all international economic contracts and related legal relationships in so far as the law of the German Democratic Republic is applicable to them, unless otherwise provided in international agreements or conventions to which the German Democratic Republic is a party, or in specific laws of the German Democratic Republic.

and did not in addition have to prove absence of reasonable care on the part of the seller.

Exclusion of implied terms[4]

8. The extent to which liability for breach of these implied terms could be excluded by agreement between the parties varied. Ireland and Sierra Leone noted that such liability could be excluded. Australia and Canada (for provinces other than Quebec) noted that, while exclusion or variation was possible under the terms of the legislation on the sales of goods imposing the implied terms, other legislation had, with a view to consumer protection, either declared such exclusion to be ineffective, or had implied other terms as to quality and fitness which could not be excluded.

9. Thus Australia noted that:

(*a*) Under the Trade Practices Act 1974, which applied to contracts wherever made involving international trade to or from Australia and between states of Australia, where goods were to be supplied to a consumer, certain conditions as to quality and suitability were implied which the parties could not exclude, restrict or modify.

(*b*) Under the Manufacturers' Warranties Act 1974 of South Australia, which applied to goods sold by retail, a warranty that the goods were of merchantable quality was implied which could not be excluded by agreement.

10. Canada noted that:

(*a*) Under the Ontario Consumers Protection Act 1970, the implied terms applying to a contract of sale of goods could not be negatived or varied by any written term or acknowledgement in the case of a "consumer sale" as defined by that Act.

(*b*) Under the Manitoba Consumer Protection Act 1970, terms closely corresponding to those set forth in paragraph 5 above were implied in a "retail sale" as defined in that Act and could not be excluded.

(*c*) Under the British Columbia Sale of Goods Act 1960, as amended, any term or agreement which purported to negate or in any way diminish the terms implied by that Act was void in the case of a "retail sale" as defined in that Act.

11. The United Kingdom noted that, under the Supply of Goods (Implied Terms) Act 1973, the implied terms set forth in paragraph 5 above could not be excluded in consumer contracts.

(ii) *The implied warranty against hidden defects, modelled on the provisions of the French Civil Code*

12. Belgium, Benin, Burundi, Canada (for the province of Quebec), Chile, Madagascar, Mauritius, Netherlands,[5] Nicaragua, Senegal and Venezuela noted that a warranty was implied in a contract for the sale of goods in the following terms:

(*a*) The seller was liable on a warranty for hidden defects in the thing sold which rendered it unfit for the use for which it was intended or which diminished its usefulness to such an extent that the buyer would not have acquired it, or would have paid a lower price for it, had he known of such defects;

(*b*) The seller was not liable if the defects were apparent, and the buyer could have ascertained them for himself;

(*c*) The seller was liable even if he was unaware of the defects;

(*d*) Where the seller was unaware of the defects, the buyer had the option of returning the thing sold and claiming back the price, or of keeping the thing and claiming a reduction of the price. The buyer could also claim the expenses occasioned by the sale;

(*e*) Where the seller was aware of the hidden defects at the time of the sale, he was liable not only to return the price, but to compensate for all damages suffered by the buyer.

13. The Philippines noted the existence of a similar scheme of liability having the following features:

(i) The seller was liable on a warranty for hidden defects in the thing sold;

(ii) The seller was so liable even if he was not aware of the defects;

(iii) An implied warranty as to quality or fitness for a particular purpose might be annexed by the usage of trade.

14. Romania noted the existence in its law of implied warranties against hidden defects in contracts for the sale of goods.

15. In respect of the provisions noted in paragraphs 12-14 above, the act entailing liability would consist of the breach of the implied warranty through the sale of goods having a hidden defect.

16. Belgium, Benin, Burundi, Madagascar and Mauritius noted that where the seller was a "professional" seller i.e. the sale occurred as part of his business, he was presumed to know of the defects. Belgium further noted that the "professional" seller could rebut the presumption by proof that, notwithstanding all possible precautions, it was impossible to foresee the defect, while Mauritius noted that the presumption was irrebuttable. Canada (for the province of Quebec) and the Netherlands noted, however, that there was no such presumption under their law.

Exclusion of implied warranty

17. Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius, Netherlands and Senegal noted that the implied warranty against hidden defects could be excluded by agreement between the parties. Canada (for the province of Quebec) and Senegal noted that the implied warranty was excluded when it was agreed between the parties that the buyer was purchasing the goods at his own risk. Such exclusion was not possible, however:

(*a*) If the seller knew of the defect (Belgium, Benin, Canada (for the province of Quebec), Madagascar, Mauritius, Netherlands, Senegal). Thus in those States mentioned in paragraph 16 above where a professional seller was presumed to know of the hidden defects, a clause excluding the implied warranty would be invalid where the seller was a professional seller, and the presumption could not be, or was not, rebutted;

[4] An agreement between the parties excluding an implied term can be regarded as a defence to an action for breach of the implied term. Although the subject of possible defences is dealt with below (II, A, question 8), it would appear that the possible exclusion of implied terms is more appropriately dealt with at this point.

[5] The implied warranty applies in the Netherlands only in a sale of specific goods.

(*b*) If the seller was guilty of *dolus* or bad faith (Belgium, Benin, Canada (for the province of Quebec), Madagascar, Mauritius, Netherlands, Senegal);

(*c*) If the exclusion endangered the essential object of the obligation (Belgium) or eliminated all responsibility on the part of the seller (Madagascar, Senegal).

18. The Netherlands noted that, in the case of a sale of *generic* goods, the law imposed liability when the goods delivered were defective as compared with other goods of the same species, or proper warnings or instructions relating to the goods were not given.

(iii) *Obligations imposed by the sales law of Scandinavian States*

19. Norway, Sweden and Denmark noted that, although their legislation on sales imposed liability on a seller who sold defective products, such liability was construed as extending only for defects making the products less valuable than they would be if they had not been defective; there was no liability under that legislation if the defects resulted in personal injury, or damage to property other than the product itself. Norway noted, however, that the liability might extend to damage to property of the buyer other than the product itself directly resulting from the defect (e.g. damage to clothing from a defective washing machine).

(iv) *Implied warranties in other States*

20. Botswana noted that under its law of sale of goods, a warranty against latent defects was implied. If the latent defect was not serious, the buyer could claim a reduction in the price (*actio quanti minoris*). If the latent defect was serious, the buyer could claim rescission of the contract, and compensation for resulting damages (*actio redhibitoria*).

21. Poland noted that the seller was liable on a warranty to the buyer when the thing sold had a defect which reduced its value or utility, when the thing did not possess the qualities which the seller had guaranteed, or when the thing had been delivered to the buyer in an incomplete state (guarantee against physical defects). However, he was not liable if the buyer knew of the defect at the time of the conclusion of the contract. If the thing sold had a defect, the buyer could resile from the contract, or request a reduction of the price.

Other cases of contractual liability

22. The Federal Republic of Germany and Poland noted that the seller was liable when he had fraudulently concealed a defect in the thing sold from the buyer. The Federal Republic of Germany also noted that the seller was liable if he had fraudulently misrepresented that the product had qualities or features which it did not have.

23. The Federal Republic of Germany also noted that the seller was liable if he had violated a pre-contractual obligation towards the buyer to disclose or examine.

24. Austria noted that a producer was contractually liable, not only to a buyer to whom he sold his products, but to any consumer who became entitled to the goods through a chain of sales or service contracts, and who used such products trusting that they were in good order. The producer was liable if there was fault on his part in relation to the goods, e.g. defective design, defective manufacture, or failure to give proper warnings of dangers inherent in the use of the products.

25. The German Democratic Republic noted that liability was based on the principle of fault.

(b) *Contracts of supply other than sale*

Hire-purchase

26. Australia noted that:

(*a*) The Hire-Purchase Acts implied in a contract of hire-purchase terms as to the quality and suitability of the goods, which could not be excluded. However, liability was dependent on fault.

(*b*) The Trade Practices Act 1974 implied in a contract of hire-purchase the same conditions as to quality and suitability of the goods as were implied by that Act in a contract of sale.[6] The terms were implied in the same circumstances as they were implied in a sale, and could not be excluded, restricted or modified.

27. Canada noted that, under the Consumer Protection Act of Manitoba 1970, terms were implied in a contract of hire purchase, closely corresponding to those implied in the case of a retail sale,[7] and that these terms could not be excluded by the parties.

Other supply contracts

28. Australia noted that the Trade Practices Act 1974[8] implied terms corresponding to those implied if the contract were a sale, and in the same circumstances, in contracts such as exchange, lease, and hire. Such terms could not be excluded, restricted or modified. Canada (in relation to provinces other than Quebec), noted that terms as to quality and fitness similar to those implied in the case of a sale of goods[9] were implied under the common law in contracts of bailment. Botswana noted that, in relation to immovable property, if an occupier of premises agreed to the use of the premises for reward, there was an implied term that the premises were as safe for the purposes of the contract as reasonable care and skill could make them.

Question 3: What persons may be liable?

Question 5: What persons may be entitled to compensation?

1. The information given separately in reply to these two questions was interrelated, and is therefore analysed together.

Restriction of rights and duties to the parties to the sale

2. The majority of States noted that, under their law of sales,

(*a*) Only the buyer was entitled under the contract to sue for compensation where a defective product caused damage; and

(*b*) Only the seller was liable to be sued under the contract (Afghanistan, Australia, Barbados, Canada, Chile, Cyprus, Denmark, Fiji, German Democratic Republic, Germany, Federal Republic of, Hungary, Ireland, Netherlands, Nicaragua, Norway, Pakistan, Philippines, Poland, Portugal, Sierra Leone, Sweden, Venezuela, the United Kingdom (in respect of English law)).

[6] See para. 9 (*a*) above.
[7] See para. 10 (*b*) above.
[8] See para. 9 (*a*) above.
[9] See para. 5 above.

3. Australia and Canada (for the province of Quebec) noted that a person contracting through an agent could be a party to a contract.

4. The following cases where contractual liability was imposed in favour of a person not a party to a sales contract were noted:

(i) Sweden noted that the seller of a defective product might be liable on an undertaking about the quality of the product to the members of a buyer's family;

(ii) The United Kingdom noted that, in Scots law, it was possible in limited circumstances for a third party on whom the parties to a contract had clearly intended to confer a benefit to sue on that contract.

Buyer entitled to compensation from a seller other than the one from whom he purchased

5. It was noted that in certain States (Belgium, Benin, Burundi, Madagascar, Mauritius, Senegal) the person entitled to compensation under a contract of sale when a defective product which had been sold caused damage was the buyer, while the person liable was the seller who had sold the product to that buyer. However, it was noted that in some of these States (Belgium, Benin, Burundi, Senegal) a buyer could sue not only his immediate seller, but any preceding seller in the line of sellers commencing with his immediate seller and ending with the producer. While, therefore, the person entitled to compensation would be a buyer, and the person liable would be a seller, such persons need not be buyer and seller in respect of the same contract of sale. Sweden noted that a manufacturer who gave an undertaking about the quality of a product might be liable on that undertaking to a buyer of that product other than the buyer to whom he had immediately sold the product.

Possible liability of producer to one who was not a buyer, or to a buyer with whom he was not in contractual relations

6. Austria noted that, under a sales contract, the buyer was entitled to claim compensation from the seller, while the seller was correspondingly liable to the buyer. Austria also noted, however, that a producer who put into circulation a product on the understanding that, through a chain of sales or service contracts the product would reach persons other than his immediate buyer, was liable to such other persons who, trusting that the product was in good order, exposed themselves or their assets to the possibility of suffering loss through defects in the product. The person entitled to compensation may in such circumstances not be party to any sales contract (i.e. he might be a member of the buyer's family) while the producer might not be in contractual relationship with the person to whom he was liable.

Question 4: Does liability differ depending on the kind of products causing the damage?[10]

1. The majority of States which replied indicated that in the sale of goods, in the absence of special agreement between the parties as to liability, the rules of contractual liability did not differ depending on the kind of products causing the damage. (Afghanistan, Australia, Austria, Barbados, Belgium, Benin, Burundi, Canada, Denmark, Fiji, German Democratic Republic, Madagascar, Norway, Pakistan, Philippines, Poland, Romania, Senegal, Sierra Leone, Sweden, the United Kingdom, Venezuela).

2. Australia noted that the application of the legal rules specifying in general terms required standards of suitability and quality of products to different types of products might produce different standards of suitability and quality for the different products.

Question 6: For what types of loss or damage can compensation be recovered?

1. The information given in response to this question is analysed under the following heads:

(*a*) Extent of liability for different types of loss.

(*b*) Rules delimiting those consequences of a breach of contract for which compensation is recoverable.

(*c*) Rules for assessing in money terms the compensation to be awarded for loss or damage.

(a) *Extent of liability for different types of loss*

2. The following observations were made on the extent of liability for different types of loss:

(i) *Physical injury to the person: pecuniary loss and non-pecuniary loss*

3. The replies of Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius and Senegal[11] indicated that, where the seller knew of the existence of hidden defects in a product at the time of sale, he was liable to pay compensation for both pecuniary loss and non-pecuniary loss ("*dommage moral*") resulting from physical injury caused by the defect. Austria, Cyprus, Denmark, Fiji, the Philippines, Poland, Romania and the United Kingdom noted that if a breach of contract as to the quality of the goods caused physical injury, compensation was recoverable for the resulting pecuniary loss. However, while the Philippines and Poland noted that compensation was also generally payable for resulting non-pecuniary loss, the following States noted that compensation was payable for such loss in the following circumstances:

(*a*) Austria, Fiji and the United Kingdom—only for pain and suffering;

(*b*) Romania—only where the physical injury interfered with the enjoyment of social or family life.

(*c*) Denmark—only if there was breach of an express warranty as to quality.

4. Botswana and Sweden noted that, where there was breach of an express undertaking as to quality, compensation was recoverable for pecuniary loss resulting from physical injury.

5. Afghanistan, Australia, Barbados, Canada (for provinces other than Quebec), Chile, Ireland, Nicaragua, Pakistan and Portugal noted that compensation was recoverable in case of physical injury.

(ii) *Damage to property other than the product itself*

6. Belgium, Benin, Burundi, Canada (for the prov-

[10] Many States noted that the manufacture and supply of certain products (e.g. food, drugs, explosives) were regulated by special laws outside the field of contractual liability. These instances are noted in II, B, 2, below.

[11] The sales law of all these States contains the implied warranty against hidden defects modelled on the provisions of the French Civil Code.

ince of Quebec), Madagascar, Mauritius and Senegal[12] noted that, where a seller knew of the existence of hidden defects at the time of the sale, he was liable to pay compensation for damage to property other than the product itself caused by the hidden defect.

7. Botswana noted that where a product sold had a serious latent defect, compensation was recoverable for damage to property other than the product itself.

8. Afghanistan, Australia, Austria, Barbados, Botswana, Canada (for provinces other than Quebec), Chile, Cyprus, Fiji, Ireland, Nicaragua, Pakistan, the Philippines, Poland, Portugal, Romania and the United Kingdom noted that, if a breach of contract as to the quality of the goods caused damage to property other than the product itself, the seller was liable to pay compensation. Norway noted that in these circumstances compensation was only payable for certain forms of direct damage to the buyer's property.

(iii) *Pecuniary loss caused by the defect unconnected with physical injury or property damage*

9. The replies of Afghanistan, Australia, Barbados, Chile, Cyprus, Denmark, Fiji, Ireland, Nicaragua, the Philippines, Poland, Portugal, Romania, Sweden and the United Kingdom indicated that compensation was recoverable where a breach of contract as to the quality of the goods caused pecuniary loss unconnected with physical injury or property damage.

10. Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius and Senegal noted that, where a seller knew of the existence of hidden defects at the time of sale, he was liable to pay compensation for pecuniary loss caused by the defect unconnected with physical injury or property damage. Where the seller did not know of the existence of the hidden defects, he was liable to pay compensation for the expenses occasioned by the sale, which might include pecuniary loss unconnected with physical injury or property damage.

11. The replies of Austria, Norway and Pakistan indicated that no compensation was recoverable for such loss.

(iv) *Infringement of non-pecuniary interest;* "dommage moral"[13]

12. The replies of Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius and Senegal[14] indicated that, where the seller knew of the existence of hidden defects in a product at the time of sale he was liable to pay compensation for "*dommage moral*" (non-pecuniary loss) caused by the defect. Benin and Madagascar noted the need to prove a causal connection between the act entailing liability and the "*dommage moral*" before compensation was recoverable.

13. The replies of Afghanistan, Philippines and Poland also indicated that "*dommage moral*" (non-pecuniary loss) was recoverable where a breach as to the quality of the goods in a contract of sale caused such loss.

14. The replies of Barbados, Ireland and Portugal indicated that compensation was recoverable for infringement of a non-pecuniary interest through a breach as to the quality of goods in a contract of sale, if loss resulted from the breach.

15. The replies of Cyprus, Fiji and the United Kingdom indicated that although normally compensation was only recoverable for pecuniary loss, there was a recent tendency to award compensation for "disappointment" suffered through a breach of contract.

16. Botswana and Pakistan noted that no compensation was recoverable for infringement of a non-pecuniary interest.

(v) *Death*

17. Afghanistan, Australia, Belgium, Pakistan and Portugal noted that compensation was recoverable where death resulted from the breach of contract.

18. Australia further noted that the compensation would be claimed by the estate of the deceased person, and that the amount recoverable would not necessarily correspond with that recoverable if the victim had lived.

19. Portugal also noted that compensation could be claimed for the following items:

(i) All expenses incurred in the effort made to save the victim, and incidental expenses such as funeral expenses;

(ii) Expenses of all persons who treated or attempted to assist the victim;

(iii) Maintenance lost by persons entitled to demand maintenance from the victim.

(b) *Rules delimiting those consequences of a breach of contract for which compensation is recoverable*

20. Several States noted the existence of rules delimiting those consequences of a breach of contract for which compensation was recoverable.

21. Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius, Netherlands (in the case of a sale of specific goods) and Senegal[15] noted that, where a seller had sold a product containing a hidden defect, the buyer could in addition to returning the goods and obtaining restitution of the price:

(i) Where the seller was in good faith he was liable cover compensation for the expenses occasioned by the sale; and,

(ii) Where the seller knew of the defects, recover compensation for all losses caused by the defect.

22. Chile, Canada (for the province of Quebec), and the Philippines formulated in somewhat similar terms a rule existing in their legal systems, i.e.:

(i) Where the seller was in good faith he was liable to pay compensation for losses which were foreseen, or could reasonably have been foreseen, at the time of the conclusion of the contract; and

(ii) Where the seller was guilty of fraud, he was liable for the losses which were:

(*a*) An immediate and direct consequence of the breach of contract (Canada (for the province of Quebec), Chile);

(*b*) Reasonably attributable to the breach of contract (Philippines).

23. Botswana, the German Democratic Republic and Ireland noted that the seller was liable to pay compensation for losses which were foreseen, or could rea-

[12] See foot-note 11.

[13] Liability for physical injury resulting in "*dommage moral*" or non-pecuniary loss has been dealt with under (i) above.

[14] See foot-note 11.

[15] See foot-note 11.

sonably have been foreseen, at the time of the conclusion of the contract.

24. The Netherlands (in the case of a sale of generic goods) and Poland noted that, in general, compensation could be obtained for losses suffered by the injured party comprising both *damnum emergens* and *lucrum cessans*.

(c) *Rules for assessing in money terms the compensation for loss caused by a breach of contract*

25. In regard to the rules for assessing the monetary compensation to be awarded for loss or damage, Canada (for provinces other than Quebec), Portugal and Sierra Leone noted that the compensation must be such as to place the person suffering loss in the position he would have been if the contract had not been broken.

26. Canada (for provinces other than Quebec) and the German Democratic Republic noted that the injured party was obliged to take reasonable measures to mitigate the loss he had suffered.

Question 7: What defences are available, and what is their effect?

The following defences were noted:

(a) *Absence of conditions necessary for liability*

1. Australia, Barbados, Canada, Mauritius, Philippines and Sierra Leone noted that it was a defence to show the absence of conditions necessary for liability to arise.

(b) Force majeure, *inevitable accident and* cas fortuit

2. Many States (Afghanistan, Belgium, Benin, Botswana, Burundi, Canada (for the province of Quebec), German Democratic Republic, Madagascar, Nicaragua, Philippines, Poland, Romania, Senegal, Venezuela) noted that *force majeure* constituted a defence to a breach of contract. The following definitions of *force majeure* were given:

(i) A force which was unforeseeable and irresistible, having regard to circumstances of time and place (Burundi).

(ii) An extrinsic event both unforeseeable and irresistible (Romania).

(iii) All direct acts of nature, the violence of which could not reasonably have been foreseen or guarded against (Botswana).

3. Canada (for the province of Quebec) noted that *force majeure* was not a defence if a party contractually bound himself to perform despite supervening *force majeure*.

4. Sierra Leone noted that inevitable accident was a defence.

5. Senegal and Venezuela noted that *cas fortuit* was a defence.

(c) *Fault of the injured party, and contributory (comparative) fault*

6. Many States (Afghanistan, Austria, Belgium, Benin, Burundi, Canada, Madagascar, Pakistan, Poland, Portugal, Romania, Senegal, Sweden, Venezuela) noted that fault of the injured party was a defence. Of these States, Austria also noted that contributory fault of the injured party only lessened the defendant's liability; Madagascar also noted that only fault exclusively on the part of the injured party was a defence, and Poland also noted that contributory action on the part of the injured party reduced the obligation to compensate depending on the circumstances, and in particular, the degree of the respective fault of the two parties. The United Kingdom noted that contributory negligence of the buyer was probably not a defence available to the seller.

(d) *Intervening act of a third person*

7. Benin, Canada (for the province of Quebec), Senegal and Venezuela noted that the intervening act of a third person causing the loss was a defence. Afghanistan, Madagascar and Romania noted that such an act was a defence, provided it was equivalent to *force majeure*. Botswana noted that such an act was a defence provided it was not initiated by the act of the defendant.

8. Belgium noted that such an act was not a defence if it did not involve fault on the part of the third person.

(e) *Assumption of risk*[16]

9. Afghanistan, Romania and Senegal recognized assumption of risk as a defence if the assumption was expressly contained in a clause of the contract. Madagascar and Sierra Leone noted that assumption of risk was a defence.

(f) *Act of the plaintiff*

10. The German Democratic Republic and Venezuela noted that it was a defence to prove that the breach of contract was occasioned by the act of the plaintiff.

(g) *Absence of fault of the defendant*

11. Austria noted that it was a defence for a producer to prove absence of fault on the part of himself or his agents.

(h) *Impossibility of performance, and change of circumstances*

12. Botswana noted that absolute impossibility of performance was a defence, and Venezuela noted that destruction of the product to be supplied, or its ceasing to be subject to commercial dealing, was a defence. The German Democratic Republic noted that it was a defence to show that the circumstances in which the contracting parties concluded the contract had been fundamentally altered.

(i) *Other defences*

13. Australia noted the existence of the following defences:

(i) As a defence to an alleged breach of an implied condition of merchantability, the seller may allege that the buyer had examined the goods before the contract was entered into, and that such an examination would have revealed the defect to a reasonable buyer;

(ii) As a defence to an alleged breach of an implied condition of fitness for purpose, the seller may prove that the goods were acquired under their patent or trade name, and that the buyer was thereby satisfied that the goods would answer his purpose, and was not relying upon the seller's skill or judgement;

(iii) As a defence to alleged liability under the Manufacturers Warranties Act 1974, the manu-

[16] The case of a sale of goods where the goods contained an apparent defect, the case where a warranty against defects was excluded by an exemption clause, and the case where it was agreed between the buyer and the seller that the buyer was buying at his own risk, may each be regarded as related to the defence of assumption of risk. They are dealt with above in II, A, questions 1 and 2, paras. 12 (*b*), 8 and 17.

facturer may prove that the defect was caused by the act of another, or by a cause independent of human control, after the goods left his control;

(iv) As a defence to alleged liability under the Trade Practices Act 1974, the supplier may prove that the goods were procured for resupply from a principal who carried on business in Australia, and that the supplier did not know and could not with reasonable diligence have ascertained that the goods did not comply with a prescribed standard, or that he relied on a representation from the principal that the goods did comply with such a standard.

Question 8: Are there fixed limits to liability?

Maximum amounts per product, injury or year[17]

1. Most States (Australia, Austria, Belgium, Benin, Botswana, Burundi, Canada, Fiji, Cyprus, German Democratic Republic, Ireland, Madagascar, Pakistan, the Philippines, Poland, Portugal, Romania, Senegal, Sierra Leone, Sweden and the United Kingdom) indicated that there were no such maximum amounts fixed by law.

2. Burundi, Canada (for the province of Quebec), Madagascar, Poland, Portugal and Sweden noted that contractual stipulations might validly fix the maximum amounts recoverable for breach of warranty.

3. Canada (for provinces other than Quebec) noted that a contractual stipulation fixing an amount payable for a breach of warranty would be upheld by the Courts if regarded as a genuine pre-estimate by the parties of the loss which they contemplated would result from the breach. However, such a stipulation would not be upheld if it was regarded as security for due performance.

Periods of prescription or limitation

(a) *"Short period"*

4. Many States whose sales law contained an implied warranty against hidden defects modelled on the provisions of the French Civil Code noted that the actions available for breach of that warranty[18] were barred unless they were instituted within a short period, the length of the period depending on the nature of the defects and the usages of the place where the sale was concluded (Belgium, Benin, Mauritius, Netherlands (in respect of a sale of specific goods), Senegal). Those States whose sales law contained a similar implied warranty noted that:

(i) The actions were barred unless instituted within 60 days (Burundi);

(ii) The actions were barred unless instituted with due diligence (Canada, for the province of Quebec).

(b) *6 months period*

5. Chile and the Philippines noted that an action on a contract of sale in respect of hidden defects in the goods sold must be instituted within six months of the delivery of the goods.

(c) *1 year period*

6. Botswana noted that the period of prescription for the *actio quanti minoris* and the *actio redhibitoria*[19] was 1 year.

(d) *2 year period*

7. Canada (in respect of the provinces of Alberta, British Columbia and Manitoba) noted that an action for breach of a contract of sale was barred unless it was instituted within 2 years of the date the cause of action arose.

(e) *3 year period*

8. Botswana noted that an action on an oral contract was prescribed in 3 years.

9. Portugal noted that, under one view, a contractual action was prescribed within 3 years of the date the injured party came to know of his right, without prejudice to the time-limit for ordinary prescription if that period had already elapsed from the date of the injurious act.

(f) *5 or 6 year period*

10. Australia, Barbados, Canada (in respect of the provinces of Nova Scotia, Newfoundland, Ontario, Prince Edward Island and Saskatchewan) and Sierra Leone noted that an action for breach of a contract of sale was barred unless it was instituted within 6 years of the date the cause of action arose. Australia also noted that, if compensation was sought for personal injuries, the period was reduced in some states of the federation as follows: Queensland, South Australia and Victoria, to 3 years and Tasmania, to 2 years 6 months. Barbados also noted that, in the case of actions against public authorities, the action must be commenced before the expiration of 1 year from the date the cause of action arose.

11. The United Kingdom noted that actions in respect of damage to property must be instituted in England within 6 years from the time of the damage, and in Scotland, when the damage was not immediately apparent, within 5 years from the time when the claimant ought reasonably to be aware of the damage.

12. Botswana noted that actions on a written contract were prescribed in 6 years.

13. Denmark noted that the limitation period was five years after the occurrence of the damage. If however the buyer, without fault on his part, was not aware of his rights, or the whereabouts of the seller, the period commenced from the time when the buyer was in a position to assert his rights.

(g) *30 year period*

14. Madagascar noted that all actions in respect of civil matters were prescribed in 30 years. The Netherlands noted that the general limitation period in respect of a contract for the sale of generic goods was 30 years, but that the principle that all contracts must be executed in good faith would prevent the buyer from delaying his action against the seller for a very long period.

(h) *Other periods*

15. Poland noted that the period of prescription of contractual claims was 1 year as between Socialist enterprises and 10 years in other relationships. It also noted that actions in respect of the warranty against physical

[17] Even where no maximum limits per product, injury or year are fixed by law, the general rules delimiting those consequences of a breach of contract for which compensation is recoverable, and the rules for assessing in money terms the compensation recoverable, will specify limits beyond which no compensation is recoverable. The available information as to these limits is contained in II, A, question 6, paras. 19-25.

[18] For an account of this warranty, see II, A, questions 1 and 2, para. 12.

[19] For an account of these actions, see II, A, questions 1 and 2, para. 20.

defects[20] were barred if the buyer did not inform the seller of the existence of the defect within 1 month of its discovery, or within 1 month after he should have discovered the defect by the exercise of due diligence. Such actions were extinguished 1 year after the date of delivery. Where an express warranty in writing as to quality had been given by the seller, an action for breach of warranty was not barred earlier than 3 months after the lapse of the period of the warranty.

16. Venezuela noted that the general limitation period was 10 years for personal civil actions, but that in a case where the seller had warranted satisfactory performance for a set period of time, the buyer was bound to notify the seller of the defect within 1 month of its discovery, and must institute action within 1 year of the notification.

Question 9: In respect of what matters does the plaintiff have the burden of proof, and in respect of what matters does it rest on the defendant?

General principle

1. Many States noted that, in principle, the plaintiff (i.e. the buyer in an action for the breach of a contract of sale through the supply of defective goods) was bound to prove the elements necessary to establish liability (Afghanistan, Australia, Austria, Barbados, Belgium, Benin, Burundi, Canada, Cyprus, Fiji, Ireland, Madagascar, Mauritius, Pakistan, Poland, Portugal, Romania, Sierra Leone, Sweden, the United Kingdom, Venezuela). However, the defendant (i.e. the seller in the action described above) was bound to prove the elements of any defence exculpating him from liability (Australia, Austria, Barbados, Belgium, Benin, Burundi, Sierra Leone, Venezuela.)

2. States with sales laws containing implied terms as to quality modelled on the Sale of Goods Act 1893 of the United Kingdom noted the following examples of matters to be proved by the plaintiff and defendant respectively in accordance with the principle stated in paragraph 1 above:

To be proved by the plaintiff—the terms of the contract (Australia, Barbados), breach of contract (Australia, Barbados, Canada (for provinces other than Quebec)) and the causal link between the breach of contract and the loss (Australia).

To be proved by the defendant—defences entailing the plaintiff's examination of the goods, or reliance on a patent or trade name (Australia) and want of consideration, mistake or frustration (Canada (for provinces other than Quebec)).

3. Canada (for provinces other than Quebec) noted that when the subject-matter of an issue was particularly within the knowledge of one of the parties, the burden of proof as to that issue was on that party.

4. States with sales laws containing the implied warranty against hidden defects modelled on the provisions of the French Civil Code noted the following examples of matters to be proved by the plaintiff and defendant respectively in accordance with the principle stated in paragraph 1 above:

To be proved by the plaintiff—the contract of sale (Mauritius), hidden defects affecting the use of the thing sold (Belgium, Mauritius), the loss suffered (Burundi, Madagascar), the causal connexion between the loss suffered and the hidden defect (Burundi, Mauritius) and the fact that the seller, if not a professional seller, was in bad faith (Mauritius).

To be proved by the defendant—that the defect did not exist at the time of the sale (Belgium) that notwithstanding all possible precautions, it was impossible for him to know of the defect (Belgium), that the loss was caused by *force majeure* (Belgium, Burundi, Venezuela), that he was not a professional seller and was in good faith (Mauritius), that the defects in the product were patent (Mauritius) and that the loss was due to the act of a third party or the fault of the plaintiff, or that the product sold had been lost (Venezuela).

5. Other States noted:

As matters to be proved by the plaintiff: the breach of contract (Sweden), the nature and extent of the loss (Denmark, Sweden), and the causal connexion between the defect and the loss suffered (Denmark, Romania).

As matters to be proved by the defendant: force majeure (Philippines, Romania), absence of fault on his part (Austria) and that the act of the plaintiff or of a third party was the cause of the loss (Romania).

6. Barbados, Canada (for the province of Quebec) and Portugal noted that the normal incidence of the burden of proof may be affected by terms in the contract on the burden of proof. Portugal noted that an agreement inverting the burden of proof was void in the following circumstances:

(*a*) If it dealt with an indispensable right, or rendered excessively difficult the exercise of his rights to one of the parties, or

(*b*) Excluded a legal means of proof, or admitted a means of proof different from the legal.

Degree of proof

7. Australia, Barbados, Canada (for provinces other than Quebec) and the United Kingdom noted that, where the burden of proof lay on a party, the degree of proof required was proof on a balance of probabilities. Portugal noted that in a case of doubt the facts must be considered to constitute the right in question.

B. Extra-contractual liability

1. Delictual (tortious) liability[21]

Question 1: On what concepts is liability based?

Question 2: What acts or omissions may entail liability?

1. The information given separately in relation to

[20] For an account of this warranty, see II, A, questions 1 and 2, para. 21.

[21] The reply of Chile was confined to contractual liability, and forms of extra-contractual liability other than delictual (tortious) liability. The reply of Austria dealt mainly with contractual liability, and the reply of the German Democratic Republic was confined to contractual liability under the Law on International Economic Contracts adopted on 5 February 1976 (see foot-note 3 above). The reply of Turkey only indicated that the legislation of Turkey did not provide a special rule with regard to the civil liability of producers, but that producers incurred certain civil liabilities for defective products through the distributors of their goods.

these two questions was interrelated, and is therefore analysed together under the two categories of fault liability and strict liability.

Fault liability

2. Many States (Afghanistan, Australia, Belgium, Benin, Burundi, Byelorussian Soviet Socialist Republic, Canada (for the province of Quebec), Denmark, Federal Republic of Germany, Hungary, Ireland, Madagascar, Mauritius, Netherlands, Nicaragua, Norway, Pakistan, Poland, Portugal, Union of Soviet Socialist Republics) noted that fault was a basis of liability. Some of these States further noted that fault included one or both of the following two bases of liability: intentional action and negligence.

Intentional action

3. Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius, Nicaragua, Poland and Venezuela noted that acts intended to cause loss entailed liability if loss ensued.

Negligence

4. Most States (Australia, Barbados, Belgium, Benin, Botswana, Burundi, Canada, Cyprus, Denmark, Fiji, Federal Republic of Germany, Hungary, Madagascar, Mauritius, Netherlands, Nicaragua, Norway, Ireland, Pakistan, the Philippines, Portugal, Sierra Leone, Sweden, United Kingdom, Venezuela) noted that negligent acts entailed liability. Some States defined negligence as failure to observe the standard of a reasonable man (Australia, Barbados, Botswana, Canada, Cyprus, Fiji, Hungary, Pakistan, Philippines, Portugal, Senegal, United Kingdom). It was also noted that a slight degree of negligence sufficed to entail liability (Burundi, Madagascar).

Requirement of breach of duty in addition to fault

5. Australia, Barbados, Botswana, Canada (for provinces other than Quebec), Cyprus, Fiji, Ireland, Pakistan, Senegal, Sierra Leone and the United Kingdom noted that negligent acts only entailed liability if the negligence involved a breach of a duty to take care owed by the defendant to the plaintiff. Such a duty arose when the defendant could reasonably foresee that his acts or omissions would be likely to cause physical loss to the person or property of the plaintiff. The following were noted as special instances of a negligent breach of duty:

(*a*) Where the defendant delivered an inherently dangerous product to A, who delivered it to the plaintiff to whom it caused damage (Cyprus, Pakistan);

(*b*) Where the defendant, knowing the dangerous nature of a product, did not inform the recipient of the danger, and the plaintiff, a third party, was injured as a result (Cyprus);

(*c*) Where the defendant enterprise did not organize its business in such a way as to exclude injury or damage to others as far as possible, and did not itself, or through its chief representatives, ensure the proper selection and direction of the employees (Federal Republic of Germany).

6. The Netherlands noted that, in order to found liability, it was necessary to prove that a faulty act was also unlawful in that it was in breach of a duty to take care. However, once the breach of a duty to take care was proved, fault on the part of a producer would often be presumed.

Variations in degree of care required

7. Australia, Burundi, Canada (for provinces other than Quebec), Ireland, Netherlands, Norway and Sweden noted that the degree of care required varied commensurately with the possible risk of injury, and Australia also noted that in relation to inherently dangerous products the standard approached strict liability.[22] Sweden noted that a very high degree of care, entailing a liability approaching strict liability, was required from industrial enterprises.

Modifications to the burden of proof of negligence[23]

8. Australia, Barbados, Cyprus, Canada (for provinces other than Quebec), Fiji, Ireland, Pakistan, Sierra Leone and the United Kingdom noted that the burden of proof of negligence normally lay on the plaintiff. However, if the circumstances in which the loss or damage was caused raised an inference that the cause was the negligence of the defendant ("*res ipsa loquitur*"), the defendant bore the burden of disproving negligence.

9. The Federal Republic of Germany noted that where an injured party proved that the origin of a defect in a product causing loss or damage could not be precisely ascertained, but that such origin was situated in an area of activity for which the manufacturer was responsible, it was presumed that the defect was attributable to negligent conduct on the part of the manufacturer. The burden lay thereafter on the manufacturer to refute this presumption by showing that he had complied with the organizational duties relating to his business, and that he had carefully selected and directed all the employees in the business. The Federal Republic of Germany also noted that, where a law was designed to have a protective effect (e.g. certain laws on the manufacture or distribution of dangerous products) fault was generally presumed from the violation of the law.

10. Portugal noted that a provision existed in its legal system that whoever caused loss to others in the exercise of a dangerous activity should make good that loss, unless he proved that he had taken all the precautions required in the circumstances.

"Development risks" (liability for defects not discoverable with the scientific knowledge available at the time of circulation of the product)

11. All States which referred to this question (Burundi, Canada, Federal Republic of Germany, Netherlands, Sweden) noted that there was no liability, as there was no fault or negligence on the part of anyone.

Fraud

12. Portugal noted that fraudulent acts entailed liability, while Botswana and Pakistan noted that a person who made a fraudulent representation as to the condition of a product was liable for resulting damage to the person to whom the representation was made. Cyprus noted that a person who fraudulently represented that a dangerous product was safe, and so misled the recipient into causing damage to a third party, was liable to that third party.

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[22] See also II, B, 1, question 4, para. 2.

[23] Issues relating to the burden of proof are dealt with in II, B, 1, question 9, below. Modifications to the burden of proof of negligence are dealt with at this point as they are relevant to the strictness of liability.

Abuse of rights

13. Venezuela noted that liability was imposed if anyone in the exercise of his rights exceeded the limits placed by good faith.

Acts or omissions entailing liability

14. In relation to the bases of liability noted above, acts or omissions only entailed liability if they were of the quality required under the respective bases of liability e.g. intentional acts, negligent acts, fraudulent acts. The following instances of the possible physical nature of acts entailing liability were noted:

(*a*) Failure or mistake in the manufacturing process, and faulty design: (Afghanistan, Australia, Belgium, Byelorussian Soviet Socialist Republic, Canada, Federal Republic of Germany, Hungary, Norway, Sierra Leone, Sweden, Union of Soviet Socialist Republics);

(*b*) Failure to give proper warning or instruction (Afghanistan, Australia, Belgium, Burundi, Byelorussian Soviet Socialist Republic, Canada, Federal Republic of Germany, Hungary, Madagascar, Norway, Sweden, Union of Soviet Socialist Republics);

(*c*) Misrepresentation of condition concerning safety (Afghanistan, Canada (for the province of Quebec), Hungary);

(*d*) Distribution of product in a dangerous condition (Afghanistan, Canada for the province of Quebec), Madagascar;

(*e*) Failure to recall a faulty product (Canada (for provinces other than Quebec), Federal Republic of Germany).

Strict liability

Liability of a person having care of a thing

15. Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius, Romania, Senegal and Venezuela noted a form of strict liability which had certain elements common under the law of all these States, but required additional elements under the law of some of these States. The common elements required to be proved by the plaintiff were:

(*a*) That the defendant had the care of a thing i.e. he had the use, control and direction of the thing; and

(*b*) Proof of loss caused by the action of that thing.

16. The following additional elements to be proved by the plaintiff were noted:

(*a*) The the thing was defective (Belgium);

(*b*) That the thing was dangerous (Romania);

(*c*) That the injury or damage consisted of death, physical injury to the person, or physical damage to property (Madagascar).

17. Assuming the requisite elements were proved, the defendant was liable unless he proved a valid defence. However, proof of the absence of negligence was not a defence, except in Mauritius. The available defences[24] were:

(*a*) *Force majeure* (Benin, Burundi, Belgium, Madagascar, Mauritius, Romania, Senegal, Venezuela);

(*b*) That the cause of the loss was the fault of the victim (Benin, Burundi, Madagascar, Mauritius, Romania, Senegal, Venezuela);

(*c*) That the cause of the loss was the act of a third person (Benin, Madagascar, Mauritius, Romania, Senegal, Venezuela);

(*d*) That the defendant was unable to prevent the act which caused the loss (Canada (for the province of Quebec));

(*e*) A contractual clause exempting the defendant from liability (Madagascar).

Act or omission entailing liability

18. The act entailing liability in the above form of strict liability was having the care of the thing causing the damage, provided the other conditions for liability noted above were also satisfied.

Other cases of strict liability

19. The Byelorussian Soviet Socialist Republic and the Union of Soviet Socialist Republics noted that organizations and individuals whose activities entailed a high degree of risk for persons in the vicinity were required to pay compensation for any damage caused by the source of the risk, unless they proved that the damage resulted from "force majeure" or from intent on the part of the injured person. Hungary noted a provision in its law that any person carrying on an activity involving substantial danger should compensate for resulting damage, but added that the provision had so far not been judicially applied to the liability of producers. It was a defence, however, to show that the damage had been caused by an unavoidable cause outside the scope of the activity, or that the loss was imputable to the conduct of the injured person.

20. Norway noted that by a process of judicial lawmaking which was still continuing absolute liability was imposed where defective products created a high degree of danger or risk, in particular danger of physical injury to human beings and animals.

21. Botswana, Portugal, Denmark and Sierra Leone noted that their laws did not impose strict liability.

Alternative remedies in contract and delict (tort)

22. Barbados, Belgium, Canada (for the province of Quebec), Netherlands, Poland, and Sierra Leone noted that a person in contractual relationship with another could sue that other in delict (tort) if the facts gave rise to delictual (tortious) liability, whether or not he could sue in contract. However, the German Democratic Republic noted that, in cases falling within its scope of application, the law on International Economic Contracts[25] excluded extra-contractual claims.

Question 3: What persons may be liable?

1. All States which replied to this question noted that every person was liable whose act or omission entailed liability under an existing basis of liability.[26] However, the potential liability of the following categories of persons was specially noted:

Persons in the chain of production or distribution of a product

(*a*) All persons in the chain of production or distri-

[24] The question of possible defences is dealt with in II, B, 1, question 7, below. Since, however, the extent of the available defences is relevant to judging the strictness of liability, the defences to this form of strict liability are noted at this point.

[25] For the scope of application of this law, see II, A, questions 1 and 2, foot-note 3.

[26] For the various bases of liability recognized by States, see II, B, 1, questions 1 and 2, above.

bution (Belgium, Benin, Burundi, Canada (for provinces other than Quebec), Senegal, Sweden);

(*b*) The producer or the assembler of a finished product (Australia, Barbados, Botswana, Byelorussian Soviet Socialist Republic, Ireland, Madagascar, Netherlands, Poland, Sierra Leone, Union of Soviet Socialist Republics);

(*c*) The supplier of component parts (Australia, Barbados, Byelorussian Soviet Socialist Republic, Madagascar, the Union of Soviet Socialist Republics);

(*d*) The wholesaler and retailer of a product (Australia, Botswana, Ireland, Madagascar, Netherlands, Sierra Leone);

Persons not in the chain of production or distribution of a product

(*e*) The service contractor (Australia, Byelorussian Soviet Socialist Republic, Poland, Union of Soviet Socialist Republics);

(*f*) Inspectors and certifiers (Canada (for provinces other than Quebec)).

2. The Byelorussian Soviet Socialist Republic and the Union of Soviet Socialist Republics noted that in many cases the law excluded any recovery of compensation from the retailer.

Vicarious liability

3. Denmark, the Netherlands, Norway, Senegal, Sweden and Venezuela noted that the general principle that an employer was vicariously liable for the delict (tort) of his employee committed in the course of his duties was applicable to products liability.

4. The Federal Republic of Germany noted that, even if an injured person proved fault of an employee in the process of manufacturing or distributing a product, an employer might exculpate himself by proof that the employee in question had been properly selected and directed. It also noted, however, that the impact of this principle had been mitigated as follows:

(*a*) An enterprise was under a duty to organize its business properly. If improper organization could be proved, the enterprise would be directly liable, irrespective of any fault of its employees.

(*b*) Where the defect in a product originated from an area of activity for which the enterprise was responsible, the burden was placed on the enterprise to disprove negligence.

Joint wrongful acts

5. Belgium, Madagascar, Nicaragua and Venezuela noted that, where damage had been caused jointly by more than one person, each was liable for the full compensation payable. Portugal noted that in such a case the liability was joint, while the Federal Republic of Germany noted that each person was jointly and severally liable.

Question 4: Does liability differ depending on the kind of products causing the damage?[27]

1. Most States (Australia, Barbados, Belgium, Benin, Botswana, Burundi, Byelorussian Soviet Socialist Republic, Canada, Cyprus, Denmark, Fiji, Germany, Federal Republic of, Hungary, Ireland, Madagascar, Mauritius, Netherlands, Norway, Pakistan, Philippines, Poland, Portugal, Romania, Senegal, Sierra Leone, Sweden, the Union of Soviet Socialist Republics, United Kingdom, Venezuela) noted that liability in delict (tort) did not differ depending on the kind of products causing the damage.

2. Some States noted that the standard of care required from a producer or supplier would increase in proportion to the dangerous character of the product in question.[28] Cyprus and Pakistan noted that a special duty of care was imposed in relation to dangerous chattels in certain circumstances.[29]

3. The Philippines noted that manufacturers and processors of food-stuffs, drinks, toilet articles and similar goods were liable for death or injuries caused by any noxious substances used.

Question 5: What persons may be entitled to compensation?

1. All States which replied to this question noted that every person who had suffered loss or injury through a delict (tort) was entitled to compensation.[30]

2. Denmark, the Federal Republic of Germany and the Netherlands noted that, in cases of physical injury, only the injured person was entitled to compensation, and that others who had sustained loss or damage as a consequence of the injury were not so entitled.

3. Where death had been caused, it was noted that the following persons were entitled to compensation:[31]

Persons suffering loss of support

(*a*) Close relatives (Burundi), all persons (Federal Republic of Germany), and a person who was not an heir of the deceased (Philippines) who had been entitled to receive maintenance from the deceased during the latter's lifetime;

(*b*) The widow and dependants of the deceased who had suffered loss of maintenance as a result of the death (Botswana);

(*c*) The spouse, children or parents of the deceased (Netherlands) and all persons (Denmark) actually maintained by the deceased during his lifetime and who had suffered loss of maintenance as a result of the death:

Other cases

(*d*) An heir, to recover reimbursement for loss of funeral expenses (Federal Republic of Germany) or to recover for the loss of the earning capacity of the deceased (Philippines);

(*e*) The estate of the deceased (Australia, United Kingdom);

(*f*) Relatives by affinity and the spouse of the de-

[27] Many States noted that the manufacture and supply of certain products (e.g. food, drugs, explosives) were regulated by special laws outside the field of delictual (tortious) liability. These instances are noted in II, B, 2, below.

[28] See II, B, 1, questions 1 and 2, para. 6, above.

[29] *Ibid.*, para. 7.

[30] The replies to question 6: "For what types of loss or damage can compensation be recovered?" indicated that recovery was not possible in some States for certain types of loss or damage. This general statement made in reply to question 5 stressed the fact that no particular category of persons was excluded from the right to compensation.

[31] In relation to question 5 above, the emphasis in the analysis is on the identity of the persons entitled to compensation. On the related question of the amount recoverable, see II, B, 1, question 6, paras. 6-8 below.

ceased, as regards compensation for grief suffered as a result of the death (Venezuela), and the spouse and children of the deceased as regards compensation for non-pecuniary loss (Portugal).

Question 6: For what types of loss or damage can compensation be recovered?

1. The information given in response to this question is analysed under the following heads:

(*a*) Extent of liability for different types of loss;

(*b*) Rules delimiting those consequences of a delict (tort) for which compensation is recoverable;

(*c*) Rules for assessing in money terms the compensation to be awarded for loss or damage.

(a) *Extent of liability for different types of loss*

Physical injury to the person: pecuniary loss and non-pecuniary loss

Pecuniary loss

2. Afghanistan, Australia, Barbados, Belgium, Benin, Botswana, Burundi, Byelorussian Soviet Socialist Republic, Canada, Cyprus, Denmark, Fiji, Germany, Federal Republic of, Hungary, Ireland, Madagascar, Mauritius, Netherlands, Nicaragua, Norway, Philippines, Poland, Portugal, Romania, Senegal, Sierra Leone, Sweden, the Union of Soviet Socialist Republics, the United Kingdom, and Venezuela noted that compensation was recoverable for pecuniary loss caused by physical injury to the person.

Non-pecuniary loss

3. Of these States, the replies of Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius, Philippines, Poland, Senegal, Sweden and Venezuela noted that, in addition, compensation was also recoverable for non-pecuniary loss classed as "*dommage moral*". However, the replies of the Byelorussian Soviet Socialist Republic, Hungary, and the Union of Soviet Socialist Republics noted that no compensation was recoverable for "*dommage moral*".

4. The replies of Afghanistan, Barbados, Denmark, Fiji, Federal Republic of Germany, Netherlands, Portugal, Romania and the United Kingdom noted that compensation was recoverable for certain forms of non-pecuniary loss. Norway noted that non-pecuniary loss was only recoverable if:

(*a*) The person injured had suffered permanent and significant injury in medical terms, or

(*b*) The injury had been inflicted wilfully or through gross negligence.

Death caused by a delict (tort): pecuniary loss and non-pecuniary loss

5. Afghanistan, Australia, Barbados, Belgium, Benin, Botswana, Burundi, Byelorussian Soviet Socialist Republic, Canada, Denmark, Fiji, Federal Republic of Germany, Hungary, Madagascar, Mauritius, Netherlands, Poland, Portugal, Union of Soviet Socialist Republics, United Kingdom and Venezuela noted that compensation was recoverable for loss resulting from the death of a person.

Pecuniary loss

6. It was noted that compensation was recoverable for the following items of pecuniary loss:[32]

(*a*) Loss of the maintenance which would have been given to the claimant by the deceased if the latter had lived (Botswana, Burundi, Denmark, Federal Republic of Germany, Netherlands, Philippines, Portugal). The Netherlands added that no compensation was payable for any other item of loss;

(*b*) Loss of the earning capacity of the deceased (Philippines);

(*c*) Medical expenses incurred in treatment (Burundi, Portugal);

(*d*) Funeral expenses (Burundi, Federal Republic of Germany, Portugal).

7. The United Kingdom noted that pecuniary loss was recoverable. Barbados noted that no compensation was recoverable by a husband or master for loss caused to him by the death of his wife or servant respectively.

Non-pecuniary loss

8. Burundi noted that compensation was payable for "*dommage moral*"; Portugal noted that compensation was payable for non-pecuniary loss; the United Kingdom noted that compensation was recoverable for pain and suffering; and the Philippines and Venezuela noted that compensation was payable for mental anguish.

Damage to property other than the product itself

9. Afghanistan, Australia, Barbados, Belgium, Benin, Botswana, Burundi, Byelorussian Soviet Socialist Republic, Canada, Cyprus, Denmark, Fiji, Germany, Federal Republic of, Hungary, Ireland, Madagascar, Mauritius, Netherlands, Nicaragua, Norway, Philippines, Poland, Portugal, Romania, Senegal, Sierra Leone, Sweden, Union of Soviet Socialist Republics and Venezuela noted that compensation was recoverable for damage caused to property other than the product itself.

10. Of these States, Burundi, Canada (for provinces other than Quebec), Fiji, Denmark, Hungary, Nicaragua, Philippines, Poland, Portugal and the United Kingdom noted that compensation was recoverable for loss of profits resulting from such damage.

Economic loss unconnected with physical injury or property damage

11. The replies of Afghanistan, Barbados, Belgium, Benin, Canada (for the province of Quebec), Hungary, Madagascar, Mauritius, Poland, Portugal, Senegal and Venezuela indicated that compensation was recoverable for such loss.

12. Canada (for provinces other than Quebec) noted that there was no general rule excluding recovery for economic loss, but that recovery was only granted in limited circumstances. Cyprus and Ireland noted that the position as to recovery was uncertain, but Cyprus also noted that recovery might be possible in certain circumstances.

13. Denmark, Fiji, Sweden and the United Kingdom noted that usually no recovery was possible for such loss.

[32] The categories of persons entitled to claim for loss of support are noted in II, B, 1, question 5, para. 3, above.

Australia noted that compensation for the decreased value of the product itself was not recoverable.

Infringement of non-pecuniary interest; "dommage moral"[83]

14. Afghanistan, Barbados, Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius, Philippines, Senegal and Venezuela noted that recovery of compensation could be obtained for infringement of a non-pecuniary interest. Of these States, Belgium, Benin, Burundi, Canada (for the province of Quebec), Madagascar, Mauritius, Philippines, Senegal and Venezuela described the possible loss resulting from infringement of a non-pecuniary interest as "*dommage moral*".

15. The Byelorussian Soviet Socialist Republic, Hungary, and the Union of Soviet Socialist Republics noted that no compensation was recoverable for "*dommage moral*". Botswana noted that no compensation was recoverable if the loss was not a "patrimonial loss".

(b) *Rules delimiting those consequences of a delict (tort) for which compensation is recoverable*

Criterion of foreseeability

16. Canada (for the province of Quebec) and the Philippines noted that compensation was recoverable for consequences which were not foreseeable. It was, however, necessary that the consequences should be:

(i) Direct and immediate consequences of the delict (tort) (Canada (for the province of Quebec));

(ii) The natural or probable consequences of the act or omission in question (Philippines).

17. Australia, Barbados and Sweden noted that compensation was limited to consequences which were reasonably foreseeable.

Causation

18. Benin, Burundi, Madagascar, Netherlands and Portugal noted that an adequate causal connexion must be proved between the consequences for which compensation was claimed and the delict (tort).

Remoteness

19. Botswana and the United Kingdom noted that the damages must not be too remote.

(c) *Rules for assessing in money terms the compensation to be awarded for loss or damage*

20. Poland, Portugal, Romania and Sierra Leone noted that the object of an award of compensation was to restore the injured party to the position he would have occupied if the delict (tort) had not been committed.

21. The Netherlands, Poland and Portugal noted that a Court had the power to mitigate the amount awarded as compensation by taking into account:

(*a*) The financial situation of the parties (Netherlands);

(*b*) The degree of culpability of the defendant, his financial situation, and the other circumstances of the case (Poland, Portugal).

[83] States where compensation is recoverable for "*dommage moral*" resulting from physical injury have been noted in paras. 2-4 above.

Question 7: What defences are available, and what is their effect?[84]

The following defences were noted:

(a) *Absence of conditions necessary for liability*

1. Many States noted that it was a defence to show the absence of conditions necessary for liability to arise. The following examples were given of circumstances under which liability did not arise:

(i) Absence of a duty of care owed by the defendant to the plaintiff in the circumstances (Australia);

(ii) Absence of defendant's negligence (Canada (for provinces other than Quebec), Ireland, Mauritius, Sierra Leone) or fault (Hungary);

(iii) Absence of causal connexion between the fault and the damage (Canada, Mauritius, Portugal);

(iv) Absence of defect in the product (Norway).

(b) *Fault of the injured party and contributory (comparative) fault*

2. Afghanistan, Australia, Barbados, Belgium, Benin, Botswana, Burundi, Byelorussian Soviet Socialist Republic, Canada, Denmark, Fiji, Germany, Federal Republic of, Hungary, Ireland, Madagascar, Mauritius, Netherlands, Norway, Pakistan, Poland, Portugal, Romania, Senegal, Sweden, Union of Soviet Socialist Republics, and the United Kingdom noted that fault of the injured party was a defence.

3. It was noted that the defendant was exculpated by proof that the extent of the plantiff's fault was such that the main responsibility for the loss lay with the plaintiff (Australia, Belgium, Burundi, Byelorussian Soviet Socialist Republic, Canada, Germany, Federal Republic of, Hungary, Madagascar, Netherlands, Poland, Romania, Union of Soviet Socialist Republics, United Kingdom).

4. It was also noted that where the fault of both parties contributed to cause the damage, the amount of compensation awarded to the plaintiff was decreased commensurately to the extent that his fault had caused the damage (Australia, Barbados, Belgium, Botswana, Byelorussian Soviet Socialist Republic, Canada (for provinces other than Quebec), Denmark, Germany, Federal Republic of, Hungary, Ireland, Netherlands, Portugal, Sweden, Union of Soviet Socialist Republics, United Kingdom).

(c) *Assumption of risk*

5. Afghanistan, Australia, Barbados, Botswana, Canada (for provinces other than Quebec), Denmark, Hungary, Madagascar, Netherlands, Norway, Romania, Sierra Leone and the United Kingdom noted that assumption of risk was a defence. Hungary noted that the defence was available only where the injury did not threaten or violate any social interest, and Romania noted that the assumption of risk must be contained in a valid contractual clause.

(d) Force majeure, cas fortuit, *act of God, inevitable accident*

6. Afghanistan, Belgium, Benin, Botswana, Burundi, Byelorussian Soviet Socialist Republic, Canada (for the province of Quebec), Hungary, Madagascar, Mauritius, Netherlands, Norway, Philippines, Poland, Romania, Senegal and the Union of Soviet Socialist Republics

[84] The defences to certain cases of strict liability have been noted in II, B, 1, questions 1 and 2, paras. 17 and 19, above.

noted that it was a defence to prove that the damage resulted from *force majeure*.[35]

7. Canada (for the province of Quebec) and Senegal noted that it was a defence to prove that the damage resulted from *cas fortuit*.

8. Barbados noted that it was a defence to prove that the damage resulted from an act of God.

9. Barbados and Sierra Leone noted that it was a defence to prove that the damage resulted from inevitable accident. Barbados noted that this defence was available "where the party charged with the offence could not possibly prevent it by the exercise of ordinary care, caution and skill".

(e) *Intervening act of a third party*

10. Afghanistan, Australia, Benin, Botswana, Canada, Denmark, Madagascar, Mauritius, Norway, Romania and Senegal noted that it was a defence to prove that an intervening act of a third party caused the loss. Afghanistan, Madagascar, and Romania noted that the act had to be equivalent to *force majeure*.

(f) *Exemption clauses*

11. Belgium, Canada (for the province of Quebec) and Sweden noted that, where an action was brought on the basis of negligence between parties in contractual relationship, the defendant could rely on a clause in the contract exempting him from liability. However, Canada (for the province of Quebec) also noted that such an exemption clause was invalid:

(i) When the clause was against public order and morality;

(ii) When the delict (tort) complained of involved *faute lourde* or gross negligence;

(iii) When one party had induced the other to accept the exemption clause by false representations.

12. Burundi, Madagascar and Mauritius noted that a contractual clause exempting a defendant from liability for fault was invalid. Canada (for the province of Quebec) noted that a clause exempting a defendant from liability for intentional wrongdoing was invalid.

Question 8: Are there fixed limits to liability?

(a) *Maximum amounts per product, injury or year*[36]

1. Most States (Australia, Barbados, Belgium, Benin, Botswana, Burundi, Byelorussian Soviet Socialist Republic, Canada, Cyprus, Denmark, Fiji, Germany, Federal Republic of, Hungary, Madagascar, Netherlands, Norway, Pakistan, Philippines, Poland, Portugal, Romania, Senegal, Sierra Leone, Sweden, the Union of Soviet Socialist Republics, United Kingdom, Venezuela) indicated that there were no such maximum limits fixed by law.

2. Denmark noted, however, that in practice ceilings had been established for recovery of compensation for disability, and for loss of support resulting from the loss of a breadwinner. Compensation for pain and suffering was also awarded on the basis of fixed rates.

3. The Philippines noted that where death was caused by fault or negligence, a minimum sum payable as compensation was fixed by law.

4. Botswana and Canada (for the province of Quebec) noted that limits were fixed by law regarding compensation payable under the Workmen's Compensation Acts.

5. Afghanistan noted that the amounts payable might be fixed by agreement.

(b) *Periods of prescription or limitation*

(a) *One- or two-year period*

6. Canada (for the province of Quebec) noted that a 1 year period applied:

(i) To actions for the recovery of compensation for personal injuries;

(ii) To actions brought by relatives of a deceased to recover compensation for loss caused by his death, the period commencing to run from the date of death. In all other cases a two-year period applied.

7. Canada also noted that in the Yukon, the Northwest Territories, Alberta, Saskatchewan, Manitoba and Prince Edward Island, a two-year period applied to actions for the recovery of compensation for personal injuries.

(b) *Three- or four-year period*

8. Botswana, Byelorussian Soviet Socialist Republic, Germany, Federal Republic of, Poland, Portugal, Romania, the United Kingdom and the Union of Soviet Socialist Republics noted the applicability of a three-year period subject to the following qualifications:

(i) The Federal Republic of Germany and Poland noted that the three-year period commenced to run from the time that the plaintiff obtained knowledge of the damage suffered, and of the person responsible therefor. Irrespective of this rule however, the action was barred after the lapse of 30 years (Federal Republic of Germany) 10 years (Poland) after the act causing the damage was committed;

(ii) Portugal noted that the three-year period commenced when the injured party obtained knowledge of his right, even though he did not know the person responsible or the extent of his loss. Irrespective of this rule, however, the action was barred by the lapse of the ordinary period of prescription after the act causing the damage;

(iii) Romania noted that the period of three years was reduced to 18 months when the action was between Socialist organizations;

(iv) The United Kingdom noted that, in case of personal injuries and death the action to recover compensation must be brought within three years of the date of injury or death as the case may be, or within three years of the plaintiff becoming aware of all the material facts which would enable him to bring an action, whichever was the longer period.

9. The Philippines noted that a four-year period applied to an action for compensation for damage resulting from fault or negligence.

[35] For definitions of *force majeure* given by Burundi, Botswana and Romania, see II, A, question 7, para. 2, above.

[36] Even where no maximum limits per product, injury or year are fixed by law the general rules delimiting the consequences of a delict (tort) for which compensation is recoverable, and the rules for assessing in money terms the compensation recoverable, will specify limits beyond which no compensation is recoverable. The available information as to these limits is contained in II, B, 1, question 6, paras. 16-19, above.

(c) *Five- or six-year periods*

10. Denmark noted that a period of five years applied to an action for compensation for damage caused by a product. The period commenced to run from the time the damage occurred, unless the person suffering damage was excusably ignorant of his claim or the whereabouts of the person responsible. Irrespective of this rule, however, an action was barred by the lapse of 20 years from the time the damage occurred.

11. Australia, Barbados, Canada (for the province of Ontario) and Sierra Leone noted that a period of six years applied, subject to the following qualifications:

(i) Australia noted that if compensation was sought for personal injuries, the period was reduced in some States of the Federation as follows: Queensland, South Australia and Victoria, to three years, and Tasmania, to two years six months;

(ii) Barbados noted that in the case of actions against public authorities the action must be commenced before the expiration of one year from the date the cause of action arose.

(d) *Ten-year period*

12. Venezuela noted that the general limitation period was 10 years for personal civil actions.

(e) *Twenty-year period*

13. Mauritius noted that a period of 20 years applied to all delictual (tortious) actions.

(f) *Thirty-year period*

14. Belgium, Benin, Burundi, Madagascar and the Netherlands noted that a period of 30 years was applicable to actions to recover compensation for damage caused by products.

Question 9: In respect of what matters does the plaintiff have the burden of proof, and in respect of what matters does it rest on the defendant?

General principle

1. Many States noted that, in principle, the plaintiff (i.e. the person claiming compensation) was required to prove the elements necessary to establish liability under the basis of liability on which he relied (Afghanistan, Australia, Barbados, Belgium, Benin, Burundi, Canada, Fiji, Germany, Federal Republic of, Hungary, Ireland, Madagascar, Mauritius, Netherlands, Norway, Pakistan, Philippines, Poland, Portugal, Romania, Senegal, Sierra Leone, Sweden, United Kingdom, Venezuela). The defendant (i.e. the person from whom compensation was claimed) was required to prove the elements of any defence exculpating him from liability (Australia, Barbados, Belgium, Benin, Burundi, Byelorussian Soviet Socialist Republic, Canada, Fiji, Germany, Federal Republic of, Hungary, Madagascar, Mauritius, Philippines, Poland, Portugal, Romania, Senegal, Sierra Leone, Union of Soviet Socialist Republics, United Kingdom, Venezuela).

Fault liability

2. In relation to fault liability, the following examples were given of the principle noted in paragraph 1 above:

To be proved by the plaintiff

(*a*) A duty of care owed by the defendant to the plaintiff (Australia, Canada (for provinces other than Quebec), Ireland, Netherlands, Pakistan);

(*b*) Fault or negligence[37] (Australia, Barbados, Belgium, Canada, Cyprus, Germany, Federal Republic of, Ireland, Mauritius, Nicaragua, Pakistan, Philippines, Senegal, Venezuela);

(*c*) Loss or damage (Australia, Belgium, Byelorussian Soviet Socialist Republic, Denmark, Hungary, Ireland, Mauritius, Nicaragua, Norway, Pakistan, Senegal, Union of Soviet Socialist Republics);

(*d*) Causal connexion between the fault and the damage (Australia, Belgium, Byelorussian Soviet Socialist Republic, Canada, Denmark, Germany, Federal Republic of, Hungary, Ireland, Pakistan, Senegal, Union of Soviet Socialist Republics, Venezuela);

To be proved by the defendant

Force majeure (Belgium, Philippines) *cas fortuit* (Philippines) and contributory negligence of the plaintiff (Barbados).

Strict liability

3. In relation to the strict liability of a person having the care of a thing,[38] the following examples were given of the principle noted in paragraph 1 above:

To be proved by the plaintiff

(*a*) That the defendant had the care of the thing (Mauritius, Senegal);

(*b*) That the thing was defective (Belgium);

(*c*) Loss or damage (Belgium, Burundi, Romania, Senegal);

(*d*) Causal connexion between the action of the thing and the loss or damage (Belgium, Burundi, Mauritius, Romania, Senegal).

To be proved by the defendant

(*a*) *Force majeure* (Belgium and Burundi);

(*b*) That the damage was caused by the exclusive fault of the plaintiff (Burundi);

(*c*) Inability to prevent the act which caused the damage (Canada (for the province of Quebec)).

Degree of proof

4. Australia, Barbados, Canada (for provinces other than Quebec), Mauritius and the United Kingdom noted that, where the burden of proof lay on a party, the degree of proof required was proof on a balance of probabilities. Portugal noted that in case of doubt the facts must be considered to constitute the right in question. Norway noted that the degree of proof required would vary with the circumstances of each case.

2. OTHER FORMS OF EXTRA-CONTRACTUAL LIABILITY

1. In addition to the delictual (tortious) liability noted in section (i) above, many States noted the existence of other forms of extra-contractual liability. The description given of the latter forms of liability was generally brief, and therefore no detailed analysis is possible.

[37] The exceptional situations where negligence is presumed and the defendant bears the burden of disproving negligence are noted in II, B, 1, questions 1 and 2, paras. 8-10, above.

[38] For a description of this basis of liability, see II, B, 1, questions 1 and 2, paras. 15-18, above.

The replies disclosed two broad approaches to the imposition of liability. Under the first approach, the law singles out for special regulation the manufacture and supply of certain products which involved a high risk of physical injury. The products frequently noted in this group were food products, drugs and explosives. Under the second approach, consumer protection is the main objective. The law singles out products which might harm consumers, and consumer contracts, and subjects them to special regulation.

Regulation of food products, drugs and explosives

(a) *Food products*

2. Madagascar, the Netherlands, Nicaragua, the Philippines and Venezuela noted that the manufacture, or sale, of food products was governed by special regulations, a breach of which entailed criminal liability. The Netherlands also noted that breach of the regulations might be relevant in determining whether there had been a breach of duty in the law of delict (tort).

3. Belgium, Benin, Burundi, Fiji and the Federal Republic of Germany noted that regulations governed the manufacture of food products, and Belgium and the Federal Republic of Germany noted that breach of such regulations may be relevant in determining the existence of delictual (tortious) liability. Burundi noted that breach of the regulations entailed strict civil liability to any person injured as a result of such breach.

(b) *Drugs*

4. Chile, Madagascar, the Netherlands, Nicaragua, the Philippines, Romania and Venezuela noted that the manufacture, or sale, of drugs was governed by special regulations, a breach of which entailed criminal liability. The Netherlands also noted that breach of the regulations might be relevant in determining whether there had been a breach of duty in the law of delict (tort).

5. Belgium, Botswana, Burundi and Fiji noted the existence of regulations governing the manufacture and distribution of drugs, and noted that the following consequences resulted from a breach of such regulations:

(i) Belgium and Botswana noted that such a breach might be relevant to determining delictual (tortious) liability to the person injured;

(ii) Burundi noted that the manufacturer or seller might be subject to strict civil liability to the person injured.

6. The Federal Republic of Germany noted the existence of a special law under which a pharmaceutical company placing a drug on the market was liable irrespective of fault or negligence to pay compensation for physical injury or death caused by the use of the drug. Such liability was, however, limited to a specified maximum amount per claimant, with an over-all maximum amount applying to all damage caused by identical products having the same defect. Norway noted that a person injured by using an improperly manufactured drug could under a special law recover compensation from the seller or manufacturer without proving fault or negligence.

7. Hungary noted that, under a special law, where death or bodily injury resulted from the use of a drug, compensation was paid by the State to the person injured or his dependants.

(c) *Explosives*

8. Burundi, Madagascar and Romania noted that special regulations applied to the manufacture and distribution of explosives. Madagascar and Romania noted that breach of the regulations entailed criminal liability, while Burundi noted that the manufacturer or seller was strictly liable to any person injured as a result of such breach.

Regulation of products, and consumer contracts, in the interests of consumer protection

(a) *Specification of standards*

9. Australia (with reference to the Trade Practices Act 1974, and the Consumer Affairs Act 1972 of Victoria) noted the existence of laws enabling an executive authority to specify standards as to the composition of products, or to require the supply to consumers of information about products. Any person suffering loss as a result of a failure to comply with such standards or requirements was entitled to recover compensation from the person in default.

(b) *Prohibitions on supply*

10. Australia (with reference to the New South Wales Consumer Protection Act 1969) also noted that orders may be made prohibiting the supply of specified goods, and that anyone supplying prohibited goods was strictly liable to a person injured as a result of such supply.

(c) *Implied obligations*

11. Australia (with reference to the Manufacturers Warranties Act 1974 of South Australia) and Canada (with reference to the Consumer Protection Act 1970 of Manitoba) noted that in a retail sale, obligations to supply goods of merchantable quality were implied which could not be excluded. Canada (with reference to the Consumer Protection Act 1971 of Quebec) noted that an obligation was implied in consumer contracts to disclose relevant information, and that other obligations were implied affecting the legal position of the parties.

C. Proposals for law reform

(a) *Proposals involving contractual liability*

1. Australia noted that the New South Wales Law Reform Commission had issued a detailed working paper on the sale of goods. Canada (for the province of Ontario) noted that legislation was proposed to reform the law as follows:

(1) Certain warranties which could not be excluded would be implied in every consumer sale for a consideration exceeding a specified sum.

(2) Liability for breach of warranty would extend to the manufacturer notwithstanding the absence of privity of contract.

(3) Certain warranties would accompany the goods regardless of resale.

(b) *Proposals involving delictual (tortious) liability*

2. Hungary noted that there was a consensus on the need to regulate products liability, and that a proposal had been made as to how the law might be regulated in the course of the forthcoming revision of the Code of Civil Procedure, but that the intention of the legislature was yet unknown.

3. The Netherlands noted that a proposal had been made to include in the section on obligations of the Civil Code the following provision:

> "A person who manufactures and puts or causes to be put into circulation a product which by reason of a defect unknown to him constitutes a danger to persons or things, is liable, if that danger materializes, as if the defect were known to him, unless he proves that it was due neither to his own fault or that of another who at his orders was engaged on the product, nor to the failure of the appliances used by him."

It was noted that this article had not been included in the Civil Code because of possible action in connexion with the European Convention on Products Liability in regard to Personal Injury and Death, and the proposed directive of the European Economic Community concerning the approximation of the laws of Member States relative to product liability.

4. Portugal noted that a provision in its Civil Code imposed liability on whoever caused loss to others in the exercise of an activity dangerous in its very nature, except where he showed that he had employed all the precautions required in the circumstances. However, in relation to products liability, this provision was currently construed only as imposing liability for losses caused by the activity of manufacturing, and not for losses caused by products after manufacture. A proposal had been made that the provision should be extended to cover losses caused by defective products after their manufacture and sale.

(c) *Proposals which may involve either or both contractual and delictual (tortious) liability*

5. The United Kingdom noted that certain governmental institutions dealing with law reform (the Law Commission and the Scottish Law Commission) had been requested by the Government to consider whether the existing law governing compensation for personal injury, damage to property or any other loss caused by defective products was adequate, and to recommend what improvements, if any, were needed in the law.

(d) *Proposals not involving either contractual or delictual (tortious) liability*

6. Mauritius noted that judicial opinion had suggested the creation of a national fund to compensate victims of accidents who could not recover compensation under the law of civil liability.

7. Sweden noted that legislation was being considered to provide compensation for personal injury caused by drugs. It was intended that the compensation would be paid under a scheme of collective insurance.

8. The United Kingdom noted that an inquiry was being conducted by a special Commission into, *inter alia*, the whole basis on which personal injury should be compensated. The Commission had been requested to consider to what extent, in what circumstances and by what means compensation should be payable in respect of death or personal injury suffered by any person through the manufacture, supply or use of goods or services.

9. Denmark noted that the national goal on a long-term basis was that all victims of accidents should be compensated at a reasonable level by the social security system. More immediate proposals involving the relationship between the social security system and claims under civil law were that:

(*a*) Payments made under the social security system should reduce the amounts which could be claimed in delict (tort);

(*b*) The social security system should not be involved in claims against the wrongdoer; and

(*c*) Any compensation paid by private sources should not result in a reduction of social security payments.

V. TRAINING AND ASSISTANCE IN THE FIELD OF INTERNATIONAL TRADE LAW

Note by the Secretary-General: training and assistance in the field of international trade law (A/CN.9/137)*

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I. SYMPOSIUM ON INTERNATIONAL TRADE LAW

1. The Commission, at its eighth session, requested the Secretary-General to "organize, in connexion with its tenth session, an international symposium on international trade law, and to seek voluntary contributions from Governments, international organizations, foundations and private sources to cover the cost of travel and subsistence of participants from developing countries".[1]

2. The Commission, at its ninth session, decided that the symposium should have as its principal theme, "Transport and financing documents used in international trade", although some time was also to be devoted to a discussion of the "UNCITRAL Arbitration Rules".[2]

3. The Sixth Committee, after considering the report of the Commission on the work of its ninth session, reported, in relevant part, to the General Assembly as follows:

"36. The Committee was unanimous in stressing the great importance of this aspect of the Commission's work. It was observed that the Commission's training and assistance programme was not only a good way of publicizing its work and generating world-wide interest in the field of international trade law, but had also the important objective of helping to create expertise in the field globally. For this reason, it was further observed, the Commission's training and assistance activities were an essential complement to its work of elaborating uniform rules inasmuch as such rules could only be effectively implemented world-wide if there were available in each State persons who were familiar with the rules.

"37. Many representatives commented favourably on specific aspects of the Commission's training and assistance programme during the past year. Appreciation was expressed, especially by representatives of developing countries, to Governments which had contributed materially towards that programme.

". . .

"39. Unanimous support was expressed for the projected second UNCITRAL Symposium on International Trade Law scheduled to take place in 1977 in connexion with the Commission's tenth session. Noting that lack of sufficient funds was threatening cancellation of the symposium, many representatives thanked those Governments which had already made or pledged voluntary contributions towards sponsoring candidates from developing countries and urged other Governments in a position to do so to give financial support to this cause.

"40. The suggestion was made that consideration should be given to financing the Commission's training and assistance programme, of such importance to developing countries, out of the regular budget of the United Nations rather than to continue relying on voluntary contributions whose availability could not be assured."[3]

4. On the recommendation of the Sixth Committee, the General Assembly, on 15 December 1976, adopted by consensus resolution 31/99, which states that:

"*The General Assembly*,

". . .

"6. *Recommends* that the United Nations Commission on International Trade Law should:

". . .

"(*b*) Continue its work on training and assistance in the field of international trade law, taking into account the special interests of the developing countries".

5. As had been requested by the Commission, the Secretary-General, by a note verbale in which he recalled the value and importance attached by the Commission to its training and assistance programme, solicited volun-

* 25 April 1977.

[1] A/10017, para. 113 (Yearbook . . . , 1975, part one, II, A).

[2] A/31/17, paras. 62-63 (Yearbook . . . , 1976, part one, II, A).

[3] *Official Records of the General Assembly, Thirty-first Session, Annexes*, agenda item 108, document A/31/390, paras. 36-40.

tary contributions from Governments towards the symposium fund. At the same time, the Secretariat carried out a sustained drive, lasting for a period of a year-and-a-half, to raise funds from the other sources recommended in the Commission's decision. The difficulties being then encountered by the Secretariat in this regard were noted by the Secretary of the Commission in a letter to individual representatives on the Commission wherein he also expressed his concern that the meagerness of funds thus far contributed might make it impossible to organize a symposium of the character contemplated by the Commission.

6. Unfortunately, all of these efforts failed to yield the hoped-for results, and in the end, in spite of the generosity of certain Governments which made or pledged contributions, the total amount of such contributions actually received ($US1,440), firmly pledged ($US2,377), or conditionally pledged (up to $US8,000) still fell greatly short of the minimum ($US25,000) which it had been estimated would be required to organize a symposium of the composition desired by the Commission.[4] Consequently, the Secretary-General was obliged, by note verbale, regretfully to inform Governments that he would be unable, owing to the insufficiency of funds contributed for the purpose, to organize the second UNCITRAL symposium on international trade law in connexion with the Commission's tenth session as planned.

7. The Commission may wish, in light of the foregoing, to consider whether it should plan on holding future symposia and, if so, whether it would not be desirable to devise a different, and more reliable, method of financing this activity. Attention may be drawn in this connexion to the suggestion made during the Sixth Committee's consideration of the report on the work of the Commission's ninth session that consideration be given to financing the Commission's training and assistance programme out of the regular budget of the United Nations.[5] The Commission may wish to consider the desirability and feasibility of such an arrangement.

II. Fellowships and internship arrangements

A. Fellowships for lawyers and government officials from developing countries at commercial and financial institutions in developed countries

8. Following a suggestion made at the fifth session of the Commission, the Secretary-General, by note verbale, urged Governments of developed countries to ascertain whether commercial and financial institutions within their respective countries would be willing to receive interns from developing countries.[6]

9. One direct result of this was that the Government of Belgium in each of the years 1974 and 1975 awarded two fellowships to candidates from developing countries for academic and practical training of six months' duration at a university in that country. Although the Government of Belgium was unable for administrative reasons to offer these fellowships in 1976, the Secretary-General has recently received a note verbale informing him of that Government's intention to reinstate the two fellowships for 1977. The Secretariat expects, as in the past, to assist the Government of Belgium in the selection of suitable recipients of the awards for 1977.

B. Internship at the Hague

10. The Secretariat has recently been informed by The Hague Conference on Private International Law that the Conference is prepared to offer a fellowship to enable a candidate from a developing country to undertake an internship of up to one year's duration at the Permanent Bureau of the Conference at The Hague. The Secretariat, in co-operation with UNITAR, is now engaged in the process of selecting a suitable candidate for such internship from among the many highly qualified candidates who had sought to participate in the second UNCITRAL symposium.

C. Internship at the International Trade Law Branch

11. During the past year, two interns received training at the International Trade Law Branch of the Office of Legal Affairs of the United Nations in New York, one under the United Nations/UNITAR programme in international law, and the other under the United Nations Office of Public Information intern programme.

ANNEX

Breakdown of voluntary contributions to second UNCITRAL symposium

As of 1 March 1977, the date of the note verbale of the Secretary-General announcing the cancellation of the symposium (see para. 6, above), the following contributions had been made or pledged:

	Donor	*Amount*
1.	*Contributions received*	
	Greece	$US 300
	Sweden	$US 1,140 (5,000 Swedish kroner)
2.	*Firm pledges*	
	Austria	approx. $US 1,377 (25,000 Austrian schillings)
	Finland	$US 1,000
3.	*Conditional pledges*[a]	
	The Federal Republic of Germany	up to $US 8,000

[4] A detailed breakdown of voluntary contributions is annexed to this report.

[5] See para. 40 of the report of the Sixth Committee, as set out in para. 3, above.

[6] The initial responses of Governments of developed countries to this appeal are described in A/CN.9/92, paras. 4-8.

[a] The pledge of the Federal Republic of Germany was conditional upon the making of similar contributions by other "western industrialized countries" which did not, however, materialize.

VI. ACTIVITIES OF OTHER ORGANIZATIONS

A. Report of the Secretary-General: current activities of international organizations related to the harmonization and unification of international trade law (A/CN.9/129)*

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INTRODUCTION

1. The United Nations Commission on International Trade Law, at its third session, requested the Secretary-General "to submit reports to the annual sessions of the Commission on the current work of international organizations in matters included in the programme of work of the Commission".[1]

2. In accordance with the above decision reports were submitted to the Commission at the fourth session in 1971 (A/CN.9/59), at the fifth session in 1972 (A/CN.9/71), at the sixth session in 1973 (A/CN.9/82),** at the seventh session in 1974 (A/CN.9/94 and Add.1 and Add.2),† at the eighth session in 1975 (A/CN.9/106)‡ and at the ninth session in 1976 (A/CN.9/119).§

3. The present report, prepared for the tenth session (1977), is based on information submitted by inter-

* 3 May 1977.

[1] Report of the Commission on its third session (A/8017), para. 172; Yearbook ..., 1968-1970, part III, A.

** Yearbook ..., 1973, part two, V.

† Yearbook ..., 1974, part two, V.

‡ Yearbook ..., 1975, part two, V.

§ Yearbook ..., 1976, part two, VI.

national organizations concerning their current work.[2] In many cases, this report includes information on progress with respect to projects for which background material is included in earlier reports.[3] Some of the international organizations, whose activities were described in the earlier reports to the Commission, either did not submit statements as to their current activities or reported that they were not currently engaged in work related to international trade law.

4. This report is arranged according to major subjects in international trade. Under each subject the relevant activities of all responding international organizations are discussed in turn. An index is set out at the end of this report which lists the names of the responding organizations and indicates the subjects under which the activities of any such organization are discussed in the body of the report.

I. International sale of goods

5. The draft agenda for the Second Inter-American Conference on Private International Law, to be convened in Uruguay by the Organization of American States (OAS), includes as one of the topics to be discussed "the international sale of goods".

6. The Hague Conference on Private International Law (the Hague Conference) has on its agenda the reconsideration of the 1955 Convention on the Law Applicable to International Sales of Goods. At its thirteenth session the Hague Conference had before it Preliminary Document J of September 1976, entitled "Note on the possible revision of the Convention of June 15, 1955, on the Law Applicable to International Sales of Goods". No final decision has yet been taken on the desirability of undertaking work in this area. However, the thirteenth session of the Hague Conference requested the Netherlands Standing Government Committee on Private International Law to study, *inter alia*, the desirability of:

(i) Including in the agenda of the fourteenth session (1980) the preparation of a protocol to the Convention of 15 June 1955 on the Law Applicable to International Sales of Goods

Permitting States Parties to that Convention not to apply it to consumer sales, or

Excluding such sales from the scope of the Convention;

(ii) Charging the upcoming fourteenth session with the question of the possible revision of this Convention, without however submitting to the fourteenth session a draft amendment.

II. International contracts

A. Formation of international contracts

7. In September 1976 the Steering Committee of the International Institute for the Unification of Private Law (UNIDROIT) re-examined a draft uniform law on the formation of international contracts in the light of an analysis prepared by the secretariat of UNIDROIT of replies to a questionnaire on the draft uniform law. This questionnaire had been sent to a large number of individuals and institutes engaged in the study of international trade law. A revised version of the draft uniform law, together with a commentary, was brought to the attention of the UNCITRAL Working Group on the International Sale of Goods in January 1977.

B. General conditions and principles for international contracts

(a) *Drafted by ECE bodies*

8. At its meeting in November 1976 the ECE Group of Experts on International Contract Practices in Industry considered two standard contracts drafted by the Asian-African Legal Consultative Committee. The ECE Group of Experts decided to examine these two standard contracts and, if that examination pointed to the desirability of harmonizing those standard contracts and the ECE General Conditions of Sale, to establish a procedure for such harmonization which would take account of the interests of all the countries concerned. It was noted that such a procedure should also take account of UNCITRAL's work on general conditions of sale and of the general conditions prepared by the other regional economic commissions of the United Nations. Any agreement by the ECE Group of Experts at its upcoming twelfth session (9-13 May 1977) on future international co-operation for the development of widely recognized general conditions of sale will be transmitted to UNCITRAL.

9. Based on the work of the ECE Group of Experts on International Trade Practices relating to Agricultural Products the following General Conditions of Sale were adopted recently: General Conditions of Sale and Rules of Survey (Valuation) for Fresh Fruit and Vegetables, including Citrus Fruit; and General Conditions of Sale and Rules of Valuation for Potatoes.

(b) *Drafted by CMEA bodies*

10. General conditions of delivery: the General Conditions of Delivery for Goods, currently in force for trade among countries members of the Council for Mutual Economic Assistance (CMEA), were approved in 1968 and modified in 1975. The modifications in 1975 concerned Cuba's accession to the General Conditions and with the responsibility of economic organizations for the non-performance or the unsatisfactory performance of their obligations. The Legal Conference of representatives of CMEA countries is keeping under review the provisions of the General Conditions of Delivery with a view to their further improvement.

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[2] Some information received has not been included because that information concerned activities unrelated to the law of international trade.

[3] Background material may be found in the reports presented to the fourth session (A/CN.9/59), the fifth session (A/CN.9/71), the sixth session (A/CN.9/82), the seventh session (A/CN.9/94 and Add.1 and Add.2), the eighth session (A/CN.9/106) and the ninth session (A/CN.9/119) and in the following: *Digest of legal activities of international organizations and other international institutions*, published by the International Institute for the Unification of Private Law (UNIDROIT); Progressive development of the law of international trade, report of the Secretary-General (1966), *Official Records of the General Assembly, Twenty-first Session, Annexes*, agenda item 88, document A/6396, paras. 26-189, (Yearbook..., 1968-1970, part one, II, B); survey of the activities of organizations concerned with harmonization and unification of the law of international trade, note by the Secretary-General, 19 January 1968 (A/CN.9/5); and replies from organizations regarding their current activities in the subjects of international trade within the Commission's work programme, note by the Secretariat, 1 April 1970 (UNCITRAL/III/CRP.2).

11. General conditions of assembly: in 1973 the Executive Committee of CMEA approved its General Conditions of Assembly and the Provision of Other Technical Services connected with the Delivery of Machines and Equipment among Organizations of the Countries members of CMEA. They apply to all contracts for assembly work concluded on or after 1 January 1974.

12. General conditions of technical servicing: in 1973 the Executive Committee of CMEA also approved the General Conditions for the Technical Servicing of Machines, Equipment and Other Industrial Products Delivered among Organizations of the Countries members of CMEA. They apply to all contracts concluded on or after 1 January 1974.

13. General principles for the provision of spare parts: the Executive Committee of CMEA also approved in 1973 the General Principles for the Provision of Spare Parts for Machines and Equipment Delivered in Trade among Countries Members of CMEA and with Yugoslavia. A set of Supplementary Conditions for the Provision of Spare Parts for Means of Transport and Equipment, approved in 1967, is annexed to those General Principles.

C. INTERNATIONAL TRADE TERMS AND STANDARDS

14. The International Chamber of Commerce (ICC) is continuing its work aimed at revising its INCOTERMS 1953 and completing them by trade terms to be applied to sales involving air, containerized and combined transport. It may be noted that a trade term called "FOB AIRPORT (named airport of departure)" was adopted in 1976 by the Council of the ICC.

15. Although the International Organization for Standardization (ISO) is not engaged in the preparation of legal texts as such, the International Standards prepared by ISO are frequently used as a basis for international contracts and tenders. ISO had published over 3,000 International Standards as of the end of 1976.

16. Under the Joint FAO/WHO Food Standards Programme the intergovernmental *Codex Alimentarius* Commission and its subsidiary bodies negotiated on a world-wide basis the technical contents of international food standards. The implementation by Governments of these international food standards in national legislation serves as a means of reducing the technical, non-tariff obstacles to the greater flow of international trade in food.

D. MODEL CONTRACTS AND CONTRACTUAL CLAUSES

(a) *Model contracts and contractual clauses in general*

17. The Economic Commission for Europe, through its Group of Experts on International Contract Practices in Industry, distributed the printed text of the "Guide for Drawing up International Contracts on Industrial Co-operation" (ECE/TRADE/124, United Nations publications, Sales No. E.76.II.E.14). The Group of Experts is now engaged in preparing a draft "Guide for drawing up international contracts between parties associated for the purpose of executing a specific project" (previously called "Guide for drawing up international consortium contracts").

18. In order to standardize, unify and simplify the documents used in their foreign trade countries members of the Council for Mutual Economic Assistance (CMEA) employ: standardized forms for insurance applications, policies and certificates; a standard form for certificate of origin of goods; a letter code for the identification of countries; model forms for accounts; model forms for contracts, riders for contracts, orders and acknowledgements of orders; and a standardized model for bank documents used in foreign trade.

19. The Commission on International Commercial Practice of the International Chamber of Commerce (ICC) is engaged in drafting model clauses for long-term contracts, taking into account international contracting practice and the relevant arbitral awards by the ICC Court of Arbitration. This work is motivated by the fact that market instability, primarily due to inflation and the increasing cost of raw materials, poses serious difficulties in the performance of long-term contracts. These difficulties relate to the adaptation of such contracts to economic changes (e.g. *force majeure* and hardship clauses) and to the computation of damages for breach of contract.

20. In 1974 the Legal Conference of the Council for Mutual Economic Assistance (CMEA) approved model licensing agreements dealing with the transfer of scientific and technical data, the transfer of "know-how", and the transfer of trade marks.

(b) *Model contracts and contractual clauses in the field of sea transport*

21. The United Nations Conference on Trade and Development (UNCTAD) has commenced work toward the drafting of Model Rules for Regional Associations and Joint Ventures in the Field of Maritime Transport. The UNCTAD secretariat will undertake to analyse the legal and economic problems involved and possibly draft model rules or legal guidelines to be considered when forming regional associations and joint ventures in the field of maritime transport. The purpose of the project is to assist co-operation among developing countries. It is intended that the model rules or guidelines will be used in technical assistance projects and will possibly be published as an official United Nations handbook.

22. The International Maritime Committee (CMI) is preparing a study on shipbuilding contracts. The study will deal with such matters as builder's performance guarantees, financing, settlement of disputes arising during construction, cancellation, delay in delivery, risk and insurance, and the requirements for concluding a binding agreement. It is hoped by the CMI that the study will facilitate the elaboration of international standard terms.

23. The International Maritime Committee (CMI) is also studying the questions relating to the liability of sea terminals, with a view to drafting internationally acceptable standards.

24. In 1967 the Conference of Chartering and Shipowning Organizations of countries members of the Council of Mutual Economic Assistance (CMEA) established a Council on Documentation. This Council has prepared and adopted a number of marine transport documents and standard agreements, particularly concerning charter-parties.

III. INTERNATIONAL PAYMENTS

A. WORK ON CONVENTIONS AND UNIFORM RULES ON INTERNATIONAL PAYMENTS

25. The International Chamber of Commerce (ICC), in close co-operation with UNCITRAL, is preparing Uniform Rules for Contract Guarantees (Tender, Performance and Repayment Guarantees). Draft uniform rules were accepted in principle by the ICC Commissions on International Commercial Practice and on Banking Technique and Practice. They were circulated in 1976 to the ICC National Committees and, through UNCITRAL, to circles not represented within the ICC. The ICC Working Party on Contract Guarantees, in which the UNCITRAL secretariat is represented as observer, will meet in spring 1977 to consider the comments on the draft rules.

26. The International Chamber of Commerce, through its Commission on Banking Technique and Practice, is engaged in revising the ICC Standard Forms for the Issuing of Documentary Credits. It intends to adapt these forms to the revised text of its Uniform Customs and Practice for Documentary Credits, while making the forms simpler to use for banks.

27. The International Chamber of Commerce is continuing its work of revising its Uniform Rules for the Collection of Commercial Paper.

B. REFORM OF THE INTERNATIONAL MONETARY SYSTEM

28. At the 1976 Madrid Conference of the International Law Association (ILA) a "workshop session" discussed the possible reform of the international monetary system on the basis of an introductory paper prepared by its Committee on International Monetary Law. This paper touched on the major topics of concern that have been considered in international fora in recent years, particularly by the International Monetary Fund.

C. VALUE CLAUSES IN INTERNATIONAL CONTRACTS AND CONVENTIONS

29. At the 1976 Madrid Conference of the International Law Association (ILA) the International Monetary Law Committee considered the subject of value clauses in international arrangements. That committee was requested to continue its work aimed at securing the validity and effectiveness of existing value clauses both in private and in public international law instruments, as well as at developing meaningful maintenance of value formulas in new international contracts and conventions.

30. The Inland Transport Committee of the ECE has noted that several international conventions on transport concluded under the auspices of the Economic Commission for Europe contain provisions concerning a unit of account based on the value of gold. Since it is difficult to convert these units of account accurately into equivalent values in national currencies, an *ad hoc* meeting in spring 1977 is to consider the "unit of account" provisions in ECE transport conventions with a view to seeking a more effective solution to the problems relating to the unit of account.

31. The International Maritime Committee (CMI) would like to see the replacement of the gold units in existing conventions on maritime law by units based on the special drawing rights of the International Monetary Fund. Howeevr, the CMI is continuing to study this question, since it is not convinced that the special arrangement for countries that are not members of the International Monetary Fund made at the recent ICAO conference to amend the Warsaw Convention on International Carriage by Air is the optimal solution.

IV. INTERNATIONAL TRANSPORT

A. TRANSPORT BY SEA

32. The UNCTAD Working Group on International Shipping Legislation met during the two parts of its fifth session to consider the work of UNCITRAL on the draft Convention on the Carriage of Goods by Sea. The UNCTAD secretariat prepared studies for the Working Group, analysing the draft provisions and suggesting modifications of the draft text where such were considered desirable (documents TD/B/C.4/ISL/19 and Supp.1 and 2; TD/B/C.4/ISL/23). The UNCTAD Working Group concluded that, taken as a whole, the draft convention adopted by UNCITRAL at its ninth session was generally acceptable and recommended to the General Assembly that an international conference of plenipotentiaries be convened under the joint auspices of UNCITRAL and UNCTAD to conclude a Convention on the Carriage of Goods by Sea. This recommendation was adopted by the Trade and Development Board of UNCTAD.

33. The draft agenda for the Second Inter-American Conference on Private International Law, to be convened in Uruguay by the Organization of American States (OAS), includes as one of the topics to be discussed "international waterborne transportation, with special reference to bills of lading".

34. The subject of charter-parties forms part of the work programme of the UNCTAD Working Group on International Shipping Legislation. The Working Group in 1975 requested the UNCTAD secretariat to undertake, in addition to its report on "Charter-parties" (TD/B/C.4/ISL/13), two major studies which are now in progress: a comparative analysis of clauses in main time-charter contracts, and a comparative analysis of clauses in voyage-charter contracts. Based on these studies and additional background material the UNCTAD Working Group will seek to identify the clauses in time- and voyage-charter parties that are susceptible to standardization, harmonization and improvement. It will also explore areas in maritime chartering activities that may be regulated by international legislation. The Working Group is expected to consider these studies in 1979.

35. The UNCTAD Working Group on International Shipping Legislation is to consider the legal problems of marine insurance at its 1978 session. In preparation, the UNCTAD secretariat is preparing a study analysing the existing legal problems in marine hull and cargo insurance, caused e.g. by ambiguities, inequities or lacunae in standard policy clauses and unsatisfactory procedures for the settlement of claims.

36. After concluding its consideration of the subjects of "charter-parties" and "marine insurance", the

UNCTAD Working Group on International Shipping Legislation will take up the topic of "general average".

37. At the request of the Committee on Shipping of UNCTAD, the UNCTAD secretariat is preparing a study concerning the legal and economic consequences for international shipping of the existence or absence of a genuine link, as defined in international conventions that are in force, between a vessel and its flag of registry. This study was to be submitted to the April 1977 session of the Committee on Shipping.

38. Based on the so-called "Maxi-draft" prepared by the International Maritime Committee (CMI), the Legal Committee of IMCO finalized a new draft Convention on Limitation of Liability for Maritime Claims, that would place maximum limits on the liability of owners of sea-going vessels. Based on this draft convention a diplomatic conference at London adopted a Convention on Limitation of Liability for Maritime Claims on 19 November 1976.

39. The International Maritime Committee (CMI), in co-operation with the International Law Association (ILA), is continuing to examine the liability resulting from collisions at sea with a view toward increased unification of the law in this area.

B. TRANSPORT BY INLAND WATERWAY

40. On 6 February 1976 the Inland Transport Committee of the ECE adopted the Convention on the Contract for the International Carriage of Passengers and Luggage by Inland Waterway (CUN).

41. The Committee of Experts of UNIDROIT engaged in preparing a draft Convention on the Contract for the Carriage of Goods by Inland Waterway could not reach agreement on the question of the exoneration of the carrier for error in the navigation of the vessel. The Governing Council of UNIDROIT has therefore decided to suspend the work on this draft convention.

42. In June 1976 a Committee of Experts of UNIDROIT completed its work on a draft Convention relating to the International Carriage of Passengers and their Luggage by Sea and by Inland Waterway in Air-Cushion Vehicles. This draft convention and the previously completed draft Convention on the Registration and Nationality of Air-Cushion Vehicles were transmitted to IMCO with a view to their adoption at a diplomatic conference to be convened by IMCO.

C. TRANSPORT OVER LAND

43. The ECLA and the Latin American Railways Association (ALAF) co-sponsored a meeting at which regulations were drafted for the implementation of the ALAF Agreement on Multinational Railroad Traffic. These regulations were formally approved by the General Assembly of ALAF in October 1976.

44. At the request of Bolivia and Chile ECLA prepared a report analysing the operations of the integrated transit system designed to expedite Bolivia's imports through the Chilean port of Arica. The report indicates that the new system of aligned customs and transport documentation considerably accelerated the transit traffic and that now the major problem was the insufficiency of railway capacity.

D. TRANSPORT BY AIR

45. The general work programme of the Legal Committee of the International Civil Aviation Organization (ICAO) includes the item "Consolidation of the instruments of the 'Warsaw System' into a single convention". After the Legal Committee concluded that the preparation of such a consolidated text was premature, the Council of ICAO on 10 December 1976 referred to the ICAO Legal Bureau the task of preparing two draft "texts of convenience": one consolidating the provisions of the instruments of the "Warsaw System" that are in force, and the other consolidating all the instruments of that system. The Legal Bureau was asked to send these draft texts to States for their comments.

46. ICAO is concerned with the lease, charter and interchange of aircraft in international operations because of the legal problems affecting the regulation and enforcement of air safety when an aircraft registered in one State is operated by an operator belonging to another State. The Legal Committee of ICAO had concluded in 1964 that the best way of solving these problems would be to delegate, on the basis of model bilateral agreements, the functions of the State of registry to the State of the operator of the aircraft concerned. In April 1976 the Council of ICAO established an expert panel which prepared a report on the problems arising from the lease, charter and interchange of aircraft in international operations and explored alternative solutions to the problems. In spring 1977 a special subcommittee of the ICAO Legal Committee will meet to consider this matter.

E. MULTIMODAL TRANSPORT

(a) *Linked to UNCTAD's work on multimodal transport*

47. The UNCTAD Intergovernmental Preparatory Group on a Convention on International Multimodal Transport is charged with preparing a preliminary draft convention on international multimodal transport. To assist the Intergovernmental Preparatory Group, the UNCTAD secretariat has prepared numerous in-depth studies on the institutional, documentary, customs, insurance, liability, economic and social aspects of such transport, as well as on the legal issues concerning questions of jurisdiction and conflicts of laws and on the possible scope of application of the proposed convention. Recent studies dealt with Protection and Indemnity Clubs (TD/B/AC.15/20) and with the scope of application, documentation, and liability of the multimodal transport operator in international multimodal transport operations (TD/B/AC.15/19).

48. The United Nations Economic Commission for Latin America (ECLA) submitted the working papers, prepared by the joint OAS/ECLA Maritime Transport Programme, for the Second Latin-American Regional Preparatory Meeting on a Convention on International Multimodal Transport, held at Buenos Aires, Argentina, in December 1976. Such preparatory meetings are held prior to sessions of the UNCTAD Intergovernmental Preparatory Group on a Convention on International Multimodal Transport.

49. The United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) will hold two regional meetings in 1977 in order to provide technical

assistance to member States of ESCAP preparing for the November 1977 session of the UNCTAD Intergovernmental Preparatory Group on a Convention on International Multimodal Transport.

50. The Inland Transport Committee of the United Nations Economic Commission for Europe co-operates with UNCTAD in the elaboration of a draft Convention on International Multimodal Transport governing the liability and documentary régime of such transport. The Inland Transport Committee also co-operates with UNCTAD in its work on standards for containers used in international intermodal transport.

(b) *Not linked to UNCTAD's work on multimodal transport*

51. The ECE Inland Transport Committee will examine certain administrative, technical, economic and legal aspects of international multimodal transport, seeking appropriate ways to promote such transport and to ensure the maximum utilization of equipment. The Committee will also study the possible standardization of requirements for containers and review the development of technology in combined transport.

52. In July 1975 the International Chamber of Commerce (ICC) revised its Uniform Rules for a Combined Transport Document, mainly in order to make liability for delay in delivery subject to the "network" system. The ICC is now discussing with several trade organizations the possible alignment of the provisions in the combined transport documents issued by these organizations with the Uniform Rules of the ICC. The ICC noted that many individual combined transport operators have issued documents based on the ICC Rules.

53. In October 1976 the United Nations Economic Commission for Latin America (ECLA) prepared a report on international multimodal transport over land in the southern zone of South America, which identified the major obstacles to the establishment of multimodal land-transport services. Subsequently, ECLA was requested to prepare a draft Convention on the Civil Liability of Railways and Trucking Companies which Provide International Transport Services in Latin America.

54. See paragraph 92 on the work of UNIDROIT aimed at drawing up uniform rules concerning the liability of persons other than the carrier who have custody of the goods before, during, or after the transport operations.

V. INTERNATIONAL COMMERCIAL ARBITRATION

A. INTERNATIONAL CONVENTIONS AND UNIFORM RULES

55. The First Inter-American Conference on Private International Law, convened by the Organization of American States (OAS) in January 1975, adopted an Inter-American Convention on International Commercial Arbitration, which is already in force among Chile, Panama and Paraguay.

56. On 26 May 1972 in Moscow, Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania and the Soviet Union signed a Convention on the Settlement by Arbitration of Civil Law Disputes Arising out of Relations Concerned with Economic, Scientific and Technological Co-operation. This Convention has entered into force.

57. In 1974 the Executive Committee of the Council for Mutual Economic Assistance (CMEA) approved uniform rules for arbitration tribunals attached to the chambers of commerce of the member States of CMEA. National arbitration rules, corresponding to these uniform rules, have been adopted by Bulgaria, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania and the Soviet Union.

B. ACTIVITIES CONCERNING SPECIALIZED TYPES OF ARBITRATION

(a) *Maritime arbitration*

58. The International Chamber of Commerce, in close co-operation with the International Maritime Committee (CMI), is studying the possibility of establishing a joint centre for international maritime arbitration.

59. CMI's International Sub-Committee is engaged in the preparation of draft Rules for Arbitration of Maritime Disputes.

(b) *Other than maritime arbitration*

60. The drafting of United Nations/ECE Arbitration Rules for Certain Categories of Perishable Products (AGRI/WP.1/GE.7/60) was substantially completed in January 1977 by the ECE Group of Experts on International Trade Practices relating to Agricultural Products. The few outstanding procedural questions are expected to be resolved in July 1977 by the ECE Working Party on Standardization of Perishable Produce. Under these rules professional trade groups designated by ECE member States (and by other interested States Members of the United Nations) will submit names of potential arbitrators which will be published in lists by the secretariat of a new institution, the United Nations/ECE Chamber of Arbitral Procedure in Agriculture. The United Nations/ECE Chamber will be composed of two members (and alternates), chosen within the framework of the ECE Committee on Agricultural Problems from names presented by the designated trade groups in Eastern Europe, and two members (and alternates) chosen from names presented by the designated trade groups in Western Europe. The members and alternates will be appointed for four-year terms, with persons from Eastern and Western Europe alternatively holding the presidency of the United Nations/ECE Chamber for two-year terms. Under the Arbitration Rules, the United Nations/ECE Chamber may be called upon to settle procedural questions, e.g. as to the place of arbitration, the appointment of an arbitrator when the respondent fails to do so, and the appointment of the presiding arbitrator or of the sole arbitrator. The secretariat of the United Nations/ECE Chamber is expected to be named by the ECE Working Party on Standardization of Perishable Produce. These Arbitration Rules are based on the arbitration rules of professional trade organizations and on the 1966 ECE Arbitration Rules. The provisions on the United Nations/ECE Chamber are modelled on the Special Committee set up under article IV of the 1961 European Convention on International Commercial Arbitration. Recent international rules on arbitral procedure, i.e. the 1975 Rules for the ICC Court of Arbitration and, especially, the new UNCITRAL Arbitration Rules, were also taken into account.

61. The International Chamber of Commerce has noted that its rules for the ICC Court of Arbitration are

too general for use in the settlement of disputes that are on the borderline between arbitration and joint power of attorney. This occurs when arbitrators are to serve as a regulating influence during the performance of long-term contracts, either by filling gaps in such contracts or by adapting them to changed circumstances. The ICC Commission on International Arbitration is engaged in preparing rules on the regulation of contractual relations.

62. In December 1976 the Council of the International Chamber of Commerce decided to establish an International Centre for Technical Expertise. Under the rules administered by this centre, parties can request the President of the ICC to appoint a neutral expert when they are confronted with a technical problem during the performance of their contract. The rules are accompanied by a model clause that can be included in international contracts.

C. INFORMATION ON ARBITRATION LAWS AND PRACTICE

63. The International Chamber of Commerce has recognized that persons involved in international trade need easily accessible and reliable sources of knowledge concerning the arbitration laws in various countries. The ICC publication "Arbitration and the law throughout the world" is now out of date and the ICC Commission on International Arbitration is preparing an updated revision of this document.

64. The ICC is also organizing seminars where lawyers and businessmen can learn about arbitration and, consequently, can then participate more effectively in future arbitration proceedings. During these seminars participants may attend lectures by leading practitioners and can take part in mock arbitration proceedings where experienced arbitrators settle typical disputes that arise in international trade. In 1977 the seminars will be completed by special programmes dealing with the determination of facts in arbitral proceedings (proof, witnesses, etc.), the difficulties in enforcing arbitral awards, and decisions by arbitrators as to the adaptation of contracts to changed external circumstances.

65. While preserving the confidentiality of arbitral awards rendered by the ICC Court of Arbitration, the International Chamber of Commerce is preparing a compilation of excerpts from awards which contain legal solutions of general interest. This will be an annual publication and the first issue is to appear in 1977.

66. At the 1976 Madrid Conference of the International Law Association (ILA), the subject of arbitration between government-controlled bodies and foreign-owned business firms was discussed on the basis of a report by the International Commercial Arbitration Committee of the ILA. It was noted that there was now a trend toward denying foreign Governments the defence of sovereign immunity in disputes arising from arrangements of a commercial nature. The difficulty inherent in identifying "commercial" transactions was recognized. The ILA is to consider in the future the practice of issuing special decrees to permit governmental agencies to agree to dispute settlement by means of arbitration (e.g. recently done in France and Spain), the applicable law when questions arising from governmental contracts are submitted to arbitration, and the enforcement of arbitral awards against agencies of foreign Governments which have assets in other countries.

VI. PRODUCTS LIABILITY

67. The Commission of the European Communities has commenced work toward harmonization of the laws of States members of the European Economic Community (EEC) concerning the protection of consumers from the consequences of using products that prove to be defective. A draft directive on the subject was prepared and submitted by the Commission to the Council of Ministers of the EEC on 9 July 1976.

68. The Legal Committee of the International Civil Aviation Organization is engaged in the preparation of a new international instrument on liability for damage caused by noise and sonic boom.

69. In June 1976 a committee of experts of UNIDROIT completed its work on a draft Convention on the Civil Liability of Owners of Air-Cushion Vehicles for Damage Caused to Third Parties. This draft convention was transmitted to IMCO with a view to its adoption at a diplomatic conference to be convened by IMCO.

VII. PRIVATE INTERNATIONAL LAW

A. IN THE FIELD OF INTERNATIONAL PAYMENTS

70. The First Inter-American Conference on Private International Law, convened by the Organization of American States (OAS) in January 1975, adopted an Inter-American Convention on Conflict of Laws for Bills of Exchange, Promissory Notes and Invoices, and an Inter-American Convention on Conflict of Laws Concerning Checks; these conventions are already in force among some States members of the OAS. The draft agenda for the Second Inter-American Conference on Private International Law, to be convened in Uruguay by the OAS, includes as topics to be discussed "conflict of laws and uniform law on checks in international circulation".

71. The Hague Conference on Private International Law is considering the preparation of an international convention revising the 1930 Geneva Convention for the Settlement of Certain Conflicts of Laws in Connexion with Bills of Exchange and Promissory Notes and possibly expanding its scope to cover also other negotiable instruments such as cheques. A preliminary feasibility study on the subject was issued in September 1976, entitled "Note on the Law Applicable to Negotiable Instruments". No final decision has yet been taken by The Hague Conference as to the preparation of an international convention in this field.

B. IN THE FIELD OF AGENCY

72. The Hague Conference on Private International Law is engaged in the preparation of a convention on the law applicable to agency. This convention would cover: (a) the relationship between principal and agent, and (b) the relationships of both principal and agent with third parties arising from the agent's activities. The scope would however be limited to the contractual aspects of agency, excluding vicarious liability for the tortious acts of the agent. Preparatory work by the Permanent Bureau of The Hague Conference consisted of legal research and documentation, including a questionnaire to Governments with commentary, and the replies of Governments to the questionnaire. At its second session, on 26

November 1975, the Special Commission on Agency adopted a Preliminary Draft Convention. Preliminary document No. 6 contains observations by Governments on this preliminary draft convention. The Special Commission on Agency met for three weeks during the thirteenth session of The Hague Conference; preliminary document No. 7 contains a summary of the state of progress at the end of the thirteenth session. It is expected that a definitive text of a convention on the law applicable to agency will be completed at the session of the Special Commission on Agency that is scheduled to be held at The Hague, 16-26 June 1977.

73. For the status of the draft Convention Providing a Uniform Law on Agency of an International Character in the Sale and Purchase of Goods, prepared by UNIDROIT, see paragraph 81 below.

C. IN OTHER FIELDS

74. The Hague Conference on Private International Law is examining the feasibility of drafting a convention on the law applicable to licensing agreements and know-how. At its thirteenth session The Hague Conference had before it a short note on the subject entitled "Note on licensing agreements and know-how". While the subject is under continuing study within the Permanent Bureau of The Hague Conference, no definitive decision has yet been taken to prepare a convention on the law applicable to licensing agreements, on the law applicable to know-how agreements, or on both of the foregoing. The thirteenth session (1976) considered the formal inclusion of this subject in the agenda of the next session to be premature.

75. The draft agenda for the Second Inter-American Conference on Private International Law, to be convened in Uruguay by the Organization of American States (OAS), includes as one of the topics to be discussed "updating of standards in force in Latin America on conflicts of laws in the area of companies and enterprises".

76. For the work of The Hague Conference on Private International Law concerning reconsideration of the 1955 Convention on the Law Applicable to International Sale of Goods, see paragraph 6 above.

VIII. AUTOMATIC DATA PROCESSING

77. In the view of the International Chamber of Commerce, the growing reliance on automatic data processing in international commercial transactions has created a situation in which uniform rules standardizing international practice which apply only to transactions that involve actual paper documents are no longer sufficient. Developments in transport technology, such as high speed aircraft and containerized transport of cargo, call for a matching acceleration in data flow. The long-term solution for speeding up the data flow in international trade calls for advanced automatic data processing techniques. Such techniques may range from simply transmitting data by telex to the sophisticated use of computers. Automatic data processing can replace—and in some areas is already replacing—the traditional documentary flow of information in international trade. However, at present automatic data processing cannot satisfy all the requirements for data flow that exist either under international conventions, under various national laws or under international commercial and financial practices. Problems arise, e.g. when the data flow is necessary for authentication to meet legal or commercial requirements, for controlling the transfer of ownership of goods, or for determining whether payment is justified. The ICC has set up a Working Party charged with identifying the banking and commercial problems involved in the use of automatic data processing in international trade, working in close co-operation with interested intergovernmental organizations, particularly the United Nations Economic Commission for Europe and UNCITRAL.

78. Within the framework of the Economic Commission for Europe (ECE), an informal task team for legal questions has been established which will examine the related problems of the signature on documents used in international trade and of authentication and other legal (rather than technical) problems arising from the use of automatic data processing and data transmission. This task team is led by the chairman of the ICC Working Party on the Legal Problems arising from the Use of Automatic Data Processing in International Trade. The task team will try to determine whether the existing problems stem from requirements under international conventions (e.g. on sale of goods or transport), national legislations, or commercial practices. Where the problems are due to national legislations, appropriate remedial action will be recommended. Where the problems are due to existing commercial practices, the task team and the ECE bodies concerned with trade facilitation will work very closely with the International Chamber of Commerce and the International Organization for Standardization (ISO) in order to develop new standards for documentary and automatic data processing procedures in international trade, taking into account not only the requirements by different national authorities but also the needs of traders and other commercial interests. A document entitled "Some legal problems of data flow in international trade" (TRADE/WP.4/GE.2/R.79) has been circulated to interested national and international organizations. The ECE secretariat was asked to learn from the bodies responsible for the Convention on Road Transport (CMR) the consequences of replacing the CMR consignment note by a message processed automatically (by telex, computer print-out or terminal display). OCTI, the organization responsible for the Convention on Rail Transport (CIM), will also be approached since the present wording of the CIM Convention requires a "consignment note". Similarly, the ECE secretariat was asked to contact the International Railway Transport Committee, which has begun work on a revised railway bill of lading.

79. The Standing Commission on Foreign Trade of the Council for Mutual Economic Assistance (CMEA) is working on the simplification and standardization of the documents employed in foreign trade. One of the aims of this work is to take account of the use of automatic data processing in the field of foreign trade.

IX. OTHER TOPICS OF INTERNATIONAL TRADE LAW

A. LAW OF AGENCY

80. The Commission of the European Communities has commenced work toward harmonization of the laws of States members of the European Economic Community (EEC) concerning the practice of the profession

of "commercial agent". A draft directive on the subject was prepared and submitted by the Commission to the Council of Ministers of the EEC in December 1976.

81. A Committee of Governmental Experts, established under the auspices of UNIDROIT, completed in 1972 a draft convention providing a uniform law on agency of an international character in the sale and purchase of goods. In December 1976 Romania expressed its readiness, in principle, to host in 1978 a diplomatic conference that would consider this draft convention.

82. For the work of The Hague Conference on Private International Law on a Convention on the Law Applicable to Agency see paragraph 72 above.

B. COMPANY LAW

83. The Commission of the European Communities has been engaged in work directed at the harmonization of the laws of member States of the European Economic Community (EEC) concerning the creation of stock corporations and the preservation or modification of the capitalization of such corporations. The Council of Ministers of the EEC adopted a directive (the so-called Second Directive on Company Law) on this subject on 13 December 1976.

84. The draft agenda for the Second Inter-American Conference on Private International Law, which is to be convened by the Organization of American States, includes as one of the topics to be discussed "updating of standards in force in Latin America on conflicts of laws in the area of companies and enterprises".

C. INDUSTRIAL AND INTELLECTUAL PROPERTY LAW

85. Within the framework of the Council for Mutual Economic Assistance three international instruments dealing with industrial and intellectual property have been adopted recently:

(*a*) In 1973 an Agreement on the Legal Protection of Inventions, Industrial and Generally Useful Designs and Trade-marks in relation to Economic, Scientific and Technical Co-operation was signed by Bulgaria, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania and the Soviet Union;

(*b*) On 5 July 1975 Bulgaria, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland and the Soviet Union signed an Agreement on the Unification of Requirements for the Preparation and Submission of Patent Applications concerning Inventions;

(*c*) On 18 December 1976 an Agreement on the Mutual Recognition of Authors' Certificates and Other Documents for Protecting Inventions was signed on behalf of Bulgaria, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania and the Soviet Union. This agreement has not yet entered into force.

86. Work is continuing within the Council for Mutual Economic Assistance with a view to further harmonization and unification of national legal rules on patents, including the preparation of possible agreements on a unified document for the protection of inventions, on model rules and unified concepts relating to inventions, on the mutual legal protection of marks and designations of origin for goods, and on improving the legal protection accorded to industrial designs.

87. The ECE Committee on the Development of Trade, in co-operation with the senior advisers to ECE Governments on science and technology, will consider drawing up a manual on licensing procedures and related aspects of technology transfer.

88. In 1974, the Legal Conference of the Council for Mutual Economic Assistance (CMEA) approved model licensing agreements concerning the transfer of scientific and technical data, the transfer of "know-how", and the transfer of trade marks.

89. For the work of The Hague Conference on Private International Law on a convention on the law applicable to licensing agreements and know-how, see paragraph 74 above.

D. INTERNATIONAL LEASING

90. UNIDROIT is examining the unique legal problems of international leasing and is currently collecting information on the characteristics and functioning of international leasing. The secretariat of UNIDROIT circulated a questionnaire (Study LIX-Doc 2, 1976) on the subject world-wide to leasing companies and experts in the field. A majority of those responding to the questionnaire favoured the adoption of international uniform rules accompanied by a model contract. In September 1976 UNIDROIT established a working group to study the suitability of the subject of leasing for unification in the light of the fiscal aspects and of the question whether leasing should be considered independently of security interests in general, bearing in mind the work of UNCITRAL on security interests. This working group is to meet in spring 1977.

E. INTERNATIONAL FACTORING

91. The secretariat of UNIDROIT prepared a preliminary report on the contract of factoring (Study LVIII-Doc 1, 1976) dealing, *inter alia*, with the practical aspects of factoring operations, factoring under various national laws, and the special problems of international factoring. This report, together with a questionnaire, was circulated to interested business circles and to legal experts. At its fifty-sixth session (May 1977) the Governing Council of UNIDROIT will decide on the method of continued work on this subject.

F. LIABILITY OF WAREHOUSER IN TRANSPORT OPERATIONS

92. Mr. Donald Hill of Queens University, Belfast, prepared a report for UNIDROIT on the possibility of drafting uniform rules concerning the liability of persons other than the carrier who have custody of the goods before, during or after the transport operations. UNIDROIT is transmitting this report to Governments and interested organizations, with a request for comments on the desirability and feasibility of drawing up such uniform rules.

G. CONVENTION ON THE HOTELKEEPER'S CONTRACT

93. The preliminary draft convention on the hotelkeeper's contract, prepared by a study group of UNIDROIT chaired by Dr. Loewe of Austria, together with

an explanatory report by the UNIDROIT secretariat, is being circulated to Governments for observations. It is intended that a committee of governmental experts will be established in the future to consider the draft convention.

X. Facilitation of international trade

A. Facilitation of co-operation in production

94. The United Nations Economic Commission for Europe convened in October 1976 an *ad hoc* meeting of experts on industrial co-operation. The discussions at this meeting were based on two notes prepared by the ECE secretariat on the subject of industrial co-operation, one entitled "The international normative framework for international industrial co-operation", and the other entitled "Legal forms of industrial co-operation practised by countries having different economic and social systems, with particular reference to joint ventures".

95. The Legal Conference of representatives of member States of the Council for Mutual Economic Assistance (CMEA) is engaged in various studies aimed at assisting in the creation of favourable conditions for increased co-operation and the development of socialist economic integration of the CMEA member States.

96. In October 1976 the Intergovernmental Group on Meat of the Committee on Commodity Problems, within the framework of the Food and Agriculture Organization (FAO) adopted guidelines for international co-operation in the livestock and meat sector. The guidelines are designed to secure a balanced expansion in meat production, consumption and trade.

B. Co-operation for expansion of international trade

97. The United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) noted that within its Asian trade expansion programme the Bangkok Agreement entered into force in June 1976. The Bangkok Agreement is intended to promote economic development through the steady expansion of trade among developing countries members of ESCAP and through technical co-operation in facilitation of international trade. Within the framework of the Bangkok Agreement ESCAP has undertaken to seek the harmonization of regulations on anti-dumping and countervailing duties; to formulate uniform rules of origin and a standard form for certificate of origin of goods; and to harmonize the national criteria for customs valuation.

98. In March 1977 the Group of Experts on Customs Questions affecting Transport of the United Nations Economic Commission for Europe (ECE) is expected to consider the extension of the scope of application of the Customs Convention on the International Transport of Goods under Cover of TIR Carnets to other regions. The Group of Experts will also explore the possibility of establishing a link among the different customs transit systems that now exist and will review the existing customs conventions with a view to their possible updating. Similarly, the ECE Committee on Inland Transport is studying the possible simplification of customs formalities and documents in the field of transport. The ECE Committee on Inland Transport is also examining the problems that arise as a consequence of the controls at frontiers and the means of preventing abuse of the simplified customs procedures.

99. The Standing Commission on Foreign Trade of CMEA has established an interim working group which is engaged in work directed at the following main objectives: (a) rationalization of the techniques of foreign trade transactions, (b) standardization and coding of information on foreign trade, and (c) standardization, unification and simplification of foreign trade documents.

100. The Joint FAO/WHO Food Standards Programme is intended to protect consumers against health hazards in food, to ensure fair practices in the food trade, and to facilitate international trade in food. This programme is carried out primarily by the intergovernmental *Codex Alimentarius* Commission.

C. Information on international trade law developments

101. In a provision of the Final Act of the 1975 Helsinki Conference on Security and Co-operation in Europe, the participating States affirmed their support for "a study, within the framework of the ECE, of the possibilities of creating a multilateral system of notification of laws and regulations concerning foreign trade and changes therein". In 1976, the ECE secretariat prepared a preliminary feasibility study (document TRADE/R.335 and Add.1) which is being circulated to national and international organizations and institutions concerned with the publication, collection, evaluation, storage and dissemination of foreign trade laws and regulations, for their comments. (The possible future system is referred to in the study by the acronym "MUNOSYST".) In November 1976 the ECE Committee on the Development of Trade decided to examine the practicability and desirability of creating such a system. An *ad hoc* meeting of experts from member States and from selected international organizations with experience in this area is to be convened in Fall 1977 in order to define the scope and appropriate directions of inquiry for a revised and complete feasibility study.

102. By agreement with the International Trade Law Branch of the United Nations Office of Legal Affairs, the United Nations Institute for Training and Research (UNITAR) agreed to include topics related to the work programme of UNCITRAL in the regional training and refresher courses in international law organized by UNITAR. Thus, at the regional training and refresher course organized for the countries members of the United Nations Economic Commission for Western Asia in Doha, Qatar, 16-20 January 1976, one of the five subjects concerned the international legal aspects of shipping and maritime transport and was taught by Justice K. K. Dei-Anang, the representative of Ghana at UNCITRAL.

103. In June 1976 UNITAR and the International Trade Law Branch agreed to organize jointly the second UNCITRAL symposium on international trade law in Vienna, Austria, from 8 to 15 June 1977, subject to the receipt of sufficient voluntary contributions for this purpose.[4] It was agreed that UNITAR would be responsible

[4] The status of the proposed symposium is reflected in document A/CN.9/137 (reproduced in chapter V, above), paras. 1-7.

for the organizational and administrative aspects of the symposium while UNCITRAL would be responsible for its substantive aspects.

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WORLD INTELLECTUAL PROPERTY ORGANIZATION (WIPO)

I. ACTIVITIES LEADING TO THE ADOPTION OF TREATIES OR AMENDMENTS THERETO

Adoption of new treaties

1. *Scientific discoveries.* At its session in September/October 1976, the WIPO General Assembly agreed that the institution of a system for the international recording of scientific discoveries at the International Bureau of WIPO for those countries which favor such a system should be effected by means of a treaty. The draft of such a treaty was prepared by the Working Group on Scientific Discoveries at its fourth session in May 1976. The Director General of WIPO was asked to make proposals to the next session of the WIPO Co-ordination Committee (September/October 1977) for the convening of the Diplomatic Conference for the adoption of the said treaty.

2. *Deposit of micro-organisms for the purpose of patent procedure.* A Diplomatic Conference for the adoption of a Treaty on the International Recognition of the Deposit of Micro-organisms for the Purposes of Patent Procedure will be held at Budapest in April 1977. The Diplomatic Conference will have before it a draft Treaty and draft Regulations on the International Recognition of the Deposit of Micro-organisms for the Purposes of Patent Procedure, prepared by the International Bureau of WIPO in accordance with the recommendations made by a Working Group which met in April 1975 and in April 1976. The proposed draft Treaty would have the effect that where, for the purposes of patent procedure, a micro-organism is deposited in one of the institutions internationally recognized for such a deposit, that deposit would satisfy the deposit requirement of all the Contracting Parties.

3. *Double taxation of copyright royalties.* A second Committee of Governmental Experts on the Double Taxation of Copyright Royalties Remitted from One Country to Another was convened by WIPO and UNESCO in December 1976. The Committee expressed the view that the solution of the problems in question may be found in the adoption of a multilateral instrument limited to general principles fitting a wide variety of cases, accompanied by a model bilateral agreement, certain provisions of which might be drawn up in several alternative versions, so as to govern the measures taken to give practical effect to the principles contained in the said Convention. The Committee asked the secretariats of WIPO and UNESCO to prepare new texts for this solution, together with a commentary, which should be submitted to governments and interested organizations for comments. A third Committee of Experts will

* 23 May 1977.

meet during 1977-1978 to prepare proposals for submission to an international conference of States to be held in 1979.

Revision of treaties or regulations

4. *Industrial property in general: revision of the Paris Convention.* Work concerning the revision of the Paris Convention for the Protection of Industrial Property will continue in 1977 and 1978. The *Ad Hoc* Committee of Governmental Experts held its third session in June 1976 and continued its examination of a number of the questions dealt with in a study prepared by the Director General of WIPO. At its session in September/October 1976, the Assembly of the Paris Union decided that a Diplomatic Conference for the Revision of the Paris Convention should be convened (at present the date is expected to be during the first half of 1978). The Assembly of the Paris Union established the Preparatory Intergovernmental Committee on the Revision of that Convention. That Committee met in November 1976. After a discussion of the questions concerning article 5A (compulsory licenses, etc.) of the Paris Convention and of the questions concerning inventors' certificates, the Committee decided that those questions should be considered again by it at its next session (June 1977) after preparation in two separate Working Groups. These Working Groups met in February and March 1977, respectively. As to the third item on its agenda—concerning preferential treatment without reciprocity and the priority period—the Committee asked the Director General of WIPO to propose a draft text for a possible article which, in essence, would allow any developing country to charge, where the owner was a national of that country, half the amount of the fees which it would charge if the owner were a national of another country. Due to lack of time, the Committee was not able to consider the fourth item on its agenda, namely, the question of unanimity or qualified majorities for the Diplomatic Conference.

5. The second session of the Committee is scheduled for June/July 1977 when it will consider the four items referred to, as well as article 5 *quater* and article 4 *bis* of the Paris Convention.

6. *Classification of goods and services for the purposes of the registration of marks: revision of the Nice Agreement.* On the basis of the recommendations of an *Ad Hoc* Committee of Experts for the Revision of the Nice Agreement which met in March 1976, and in the light of studies which that Committee asked the International Bureau of WIPO to undertake, proposals concerning the revision of the Nice Agreement concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks will be submitted to a Diplomatic Conference convened to meet in May 1977. The proposals relate to the procedure for the adoption by the Committee of Experts of amendments to the International Classification.

7. *Appellations of origin: revision of the Lisbon Agreement.* The study of the revision of the Lisbon Agreement for the Protection of Appellations of Origin and their International Registration or the conclusion of a new treaty on the same and related subjects (including those covered by the Madrid Agreement for the Repression of False or Deceptive Indications of Source on Goods, if that Agreement is not to be revised) will be continued. A revised draft Treaty on the Protection of Geographical Indications will be examined by a Committee of Experts in 1977 and 1978. A Diplomatic Conference on the subject may be convened to meet in 1979.

8. *Appellations of origin: regulations under the Lisbon Agreement.* At their sessions in September/October 1976, the Assembly and the Council of the Lisbon Union modified the Regulations for carrying out the Lisbon Agreement for the Protection of Appellations of Origin and their International Registration, principally to take into account the situation by the entry into force on October 31, 1973, of the Stockholm Act (1967) of the Lisbon Agreement. The Regulations as modified also provide for the possibility of renouncing protection in one or some of the countries party to the Lisbon Agreement and for treating a subsequent request for protection in a given country as a modification rather than as a new international registration.

9. *Industrial designs: regulations under the Hague Agreement.* A Working Group on the regulations under the Hague Agreement concerning the International Deposit of Industrial Designs met in February 1976 and adopted the text of new draft Regulations under the Hague Agreement. The draft regulations are intended to replace, after the entry into force of the Protocol of Geneva of 1975 to the Hague Agreement, the Regulations for carrying out the Hague Agreement as revised at London in 1934 and at The Hague in 1960. In the event of the entry into force of the Portocol of Geneva of 1975 to the Hague Agreement, the Assembly and Conference of Representatives of the Hague Union will be convened to adopt the regulations based on that Protocol and to consider the administrative instruction based on that Protocol.

10. *New varieties of plants: revision of the UPOV Convention.* A Diplomatic Conference for the revision of the International (UPOV) Convention for the Protection of New Varieties of Plants will be held in October 1978. The Committee of Experts on the Interpretation and Revision of the UPOV Convention held two sessions in 1976 and will hold two sessions in 1977 and another in 1978 to discuss proposals for amendments to the UPOV Convention. The Working Group on Variety Denominations will also hold sessions in 1977 and possibly in 1978 to consider proposals concerning the amendment of article 13 of the UPOV Convention.

II. Measures taken with a view to the implementation of more effective application of treaties

11. Committees of Experts and Working Groups, assisted by the International Bureau of WIPO, continued during 1976, and will continue in 1977, their work in adopting or recommending measures for the implementation and more effective application of international treaties in force, or about to enter into force, in the field of industrial property, in particular those concerning patents and trademarks. These measures concern both procedural and substantive matters under the said treaties and arrangements for servicing the intergovernmental bodies established by the treaties.

Procedural matters

12. Draft forms and administrative instructions to be employed by international authorities to be established under the Patent Co-operation Treaty (PCT) and the Trademark Registration Treaty (TRT) have been prepared or are under preparation. Draft guidelines setting forth the duties of offices receiving applications under the PCT and draft guidelines for applicants using the PCT have also been prepared. Draft guidelines for publication and for drawings under the PCT are being prepared. In addition, a draft model agreement between the International Bureau of WIPO and the International Searching Authorities under the PCT has been prepared.

13. As concerns international co-operation to resolve problems of organization, storage and retrieval of technical information contained in patent documents, particularly in connection with the searching or examination of applications for patents, inventors' certificates, or similar titles, a number of activities continued to be undertaken including, in particular, the standardization of the form of documents, the processing, communication and exchange of documents, abstracting, indexing, classification and the development of other search tools.

14. With respect to patent documents, studies were carried out on problems relating to the size and other physical characteristics of published patent documents, on the characteristics pertaining to the layout and presentation and the production and reproduction as well as the identification of patent documents. Draft recommendations were prepared, or are in preparation, including a standard code for the representation of names of independent States and other entities which issue patent documents and international organizations in the field of industrial property, or concerning bibliographic data, and the

identification of different kinds of patent documents. Draft guidelines are in preparation concerning the titles of inventions in patent documents, the inclusion of references cited in patent documents, the numbering of patent and like applications, the layout and the presentation of the first page of patent documents, the size of margins, the physical characteristics of patent documents, the standardization of computer output microforms (COM), photo-optically generated microfiches, and official gazettes and journals.

15. Work will continue on the revision of the international classifications established under existing international treaties as well as the preparation for the convening of committees of experts to review the international classifications established under international treaties which will come into force. These classifications are provided for under the Strasbourg Agreement Concerning the International Patent Classification of March 24, 1971, the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks of June 15, 1957, as revised at Stockholm on July 14, 1967, and the Vienna Agreement establishing an International Classification of the Figurative Elements of Marks of June 12, 1973.

16. As concerns patent documents, the International Patent Classification (IPC) provides for a system according to which each patent document is assigned a classification symbol corresponding to specified fields of technology to which the invention description in the document pertains. This system facilitates, in turn, the physical storage and retrieval of patent documents and narrows the search for relevant references. As to marks, the classification according to goods and services and the classification according to figurative elements facilitates the search for identical or similar marks by those interested in knowing whether any mark (already deposited or expected to be deposited) may be in conflict with another mark and thus limits the scope of the search and enable the search to be undertaken in a faster and cheaper way.

17. Studies will also be undertaken to improve the procedures for the furnishing by national and regional patent offices to the International Patent Documentation Centre (INPADOC), established under an agreement between WIPO and the Government of Austria, of bibliographic data concerning patent documents in machine-readable form, as well as the arrangements for the dissemination of information by INPADOC to such offices, to industry and to information, research and development centres, particularly in developing countries.

Substantive measures

18. Reference should be made to the continuation of work in the field of trademarks and in the protection of plant varieties concerning denominations and the examination of the criteria for the grant of rights.

19. As concerns common denominations, searches will be made in the International Registry of Marks, established at the International Bureau of WIPO, in accordance with a procedure for the conduct of trademark searches by the International Bureau of WIPO with respect to common names for pesticides proposed by the Technical Committee of the International Organization for Standardization (ISO) which is responsible for adopting internationally recognized names for pesticides and related products. Under the procedure, ISO is informed of conflicting trademarks for the same or similar products. In addition, the International Bureau of WIPO draws the attention of national or regional industrial property offices to the list of common names adopted by ISO and procedures for their choice with a view to safeguarding rights of present holders and enquires as to the protection which could be given to prevent such names from being subsequently appropriated as trademarks.

20. Within the framework of the administration of the International Convention for the Protection of New Varieties of Plants which prescribes that each new variety, if protected, shall be given a denomination, guidelines for variety denominations are being established and recommended for application by the authorities of the states party to the Convention. These guidelines contain provisions on the nature or character which the denominations must meet in order to be approved by the said authorities.

21. Also within the framework of the administration of the International Convention for the Protection of New Varieties of Plants, guidelines are being prepared for the conduct of tests for distinctness, homogeneity and stability for each species of crops. In addition, the possibilities are being studied for introducing co-operation between authorities of member States, on the results of the examination. The measures for co-operation which are under study include centralizing the testing of varieties in the initial stage and an examination on the national level in later stages, the exchange of test results and test reports, particularly through the conclusion of bilateral agreements (for which a draft model agreement has been prepared), and the harmonization of application forms, technical questionnaires, test reports and fees.

Servicing, in co-operation with other specialized agencies, of meetings of intergovernmental bodies established under international treaties

22. Joint, parallel or other co-operative efforts are planned for the servicing of the meetings of intergovernmental bodies established under international treaties in the field of copyright and neighboring rights.

23. The Intergovernmental Committee, established under article 32 of the International Convention for the Protection of Performers, Producers of Phonogrammes and Broadcasting Organizations (Rome Convention) will be convened jointly with the International Labour Organisation (ILO) and the United Nations Educational, Scientific and Cultural Organization (UNESCO) in December 1977. Officials of the secretariats of the three organizations, designated by the Directors General thereof, constitute the secretariat of the Committee.

24. The Executive Committee set up under the Berne Convention for the Protection of Literary and Artistic Works (Stockholm Act, 1967 and Paris Act, 1971) will meet in extraordinary session in December 1977 in conjunction with a meeting of the Intergovernmental Copyright Committee established under the Universal Copyright Convention. The International Bureau of WIPO provides the secretariat for the former Committee and the secretariat of UNESCO provides the secretariat for the latter.

III. ACTIVITIES POSSIBLY LEADING TO THE ADOPTION OF NORMATIVE TEXTS, THE FINAL FORM OF WHICH HAS NOT YET BEEN DECIDED UPON

25. *Computer programmes.* On the basis of the guiding principles formulated by, and the discussions of, an Advisory Group of Non-Governmental Experts on the Protection of Computer Programs, including those of its third session in May 1976, the International Bureau of WIPO is preparing a new draft of model provisions for national laws relating to the legal protection of computer software, accompanied by notes explaining certain choices, giving alternative solutions and indicating the arguments for and against the solutions suggested. The model provisions will be followed by an account of the arguments for and against the establishment of a system for the deposit or registration of computer software.

26. The International Bureau of WIPO will also prepare a draft Agreement for the Protection of Computer Software and its International Deposit reflecting the solutions adopted in the model provisions.

27. *Protection of consumers.* During 1977, the International Bureau of WIPO will undertake a study with a view to exploring the possibilities of international co-operation for preventing and repressing unfair competition with particular regard to the interests of consumers. A committee of experts dealing with this question will meet in 1978 and 1979.

28. *Surveys and studies on copyright matters.* The International Bureau of WIPO, in co-operation with the secretariat of UNESCO, continued the work called for by the Executive

Committee of the Berne Union and the Intergovernmental Copyright Committee established under the Universal Copyright Convention, namely, the survey on problems arising from the use of audiovisual cassettes and discs, on problems arising from the transmission by cable of television programs, on problems arising from the use of electronic computers and related facilities for access to or the creation of works, and on the application of the revised Paris texts of 1971 of the Berne and Universal Convention.

29. *Surveys and studies on neighboring rights.* The International Bureau of WIPO, jointly with secretariats of ILO and UNESCO, will complete, in 1977, the inquiries called for by the Intergovernmental Committee of the International (Rome) Convention for the Protection of Performing Artists, Producers of Phonogrammes and Broadcasting Organizations as regards experience in the administration of the rights provided for by the Convention, moneys collected and distributed, the incidence of piracy and relevant case law and regarding copyright royalties.

IV. Preparation of model laws and model provisions

30. *New model law for developing countries on inventions and know-how.* On the basis of drafts prepared by the International Bureau, a Working Group has been working since November, 1974, on the preparation of a new model law for developing countries on inventions and know-how.

31. The Working Group will hold one session in 1977 and one final session in 1978. After the 1977 session, the complete draft texts will be sent for comments to the Governments of the States members of the Permanent Committee. The 1978 session will, on the basis of the comments received, review the texts once more. The texts will be published in Arabic, English, French and Spanish in 1979 and 1980.

32. *New model law for developing countries on trademarks and related matters.* The International Bureau will revise the 1967 BIRPI Model Law for Developing Countries on Marks, Trade Names, and Acts of Unfair Competition and will prepare the draft of a new model law on the same subject, accompanied, in part, by model regulations and explanatory notes (commentary). A working group, to be established on the recommendation of the Permanent Committee, will review these drafts and advise the International Bureau; it will hold one session in 1977, two sessions in 1978 and one session in 1979.

33. *Model Law for Arab States on trademarks.* In accordance with the decision of the Committee of Experts which had met in Tunis in June, 1975, to study the draft of a Model Law for Arab States on Trademarks, the secretariat of the Industrial Development Centre for Arab States (IDCAS) and the International Bureau, in co-operation with the Chairman of the Committee, prepared in October, 1975, a revised draft on the basis of the observations and proposals submitted during that meeting.

34. The revised draft was submitted to a Drafting Committee which met at Doha, Qatar, in November, 1975, at the invitation of the Government of Qatar. The Drafting Committee completed the revised draft and adopted the final text of the Model Law. The Model Law, which was prepared in Arabic, has been translated into English and French and was printed by the International Bureau in these three languages in one volume.

35. *Model laws for English-speaking African countries.* Within the framework of the Conference on Industrial Property Laws of English-Speaking Africa ("The Industrial Property Conference") and its two Committees (for patent matters and for trademark and industrial design matters), the secretariat of which is provided by WIPO and the United Nations Economic Commission for Africa (ECA), model laws for English-speaking African countries on industrial property subjects are being prepared.

36. A draft model law for English-speaking African countries on patents, utility certificates and innovations, together with a commentary, was prepared by the International Bureau of WIPO in consultation with the ECA and with the assistance of consultants from the patent offices of English-speaking African countries. The draft was reviewed by the Committee for Patent Matters at its meeting in December 1976. A revised draft will be prepared by the secretariat in the light of the suggestions and observations of the Committee, as well as further developments in the work of the WIPO Working Group on the Model Law for Developing Countries on Inventions and Know-how.

37. The Committee for Trademark and Industrial Design Matters, which also met in December 1976, examined a report on the results of a trademark questionnaire sent to the trademark offices of all English-speaking African countries, prepared by the Secretariat of the ECA, and an outline of provisions on marks, prepared by the International Bureau of WIPO. The Committee gave guidance to the interim secretariat concerning the drafting of a model law on marks for English-speaking African countries. In addition, the Committee requested the interim secretariat to carry out a survey on the desirability of establishing independent industrial design systems in the region and to prepare an outline of possible model provisions on industrial designs.

38. *Model law on copyright.* A committee of governmental experts to prepare a model law on copyright for the developing countries was convened by the Government of Tunisia with the assistance of WIPO and UNESCO in Tunis in February/March 1976. Delegations from 27 developing countries took part in the work of the Committee. The Palestine Liberation Organization, four intergovernmental organizations and 16 international non-governmental organizations sent observers.

39. The discussions were based on a draft model law, finalized by the International Bureau and the secretariat of UNESCO following the meeting of a committee of African experts in Abidjan in October 1973, and a commentary on that draft prepared by the two secretariats, as well as on the comments received from States and from interested international organizations. After a general discussion, the Committee adopted the text of the Model Law on Copyright for Developing Countries, and asked the two secretariats to revise the text of the commentary which accompanied the draft model law in the light of its discussions and decisions.

40. The publication of the Model Law for Developing Countries on Copyright in four languages will be continued and completed, jointly with UNESCO, in 1977.

41. *Model provisions for the implementation of the Brussels Convention Relating to the Distribution of Programme-Carrying Signals by Satellite (1974).* The International Bureau of WIPO, in conjunction with the secretariat of UNESCO, will prepare model provisions, taking into account the different needs of different countries, for the implementation of the Brussels Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite (1974).

V. Guidelines and model agreements

42. *Guidelines on industrial property licensing in developing countries.* A Working Group on Guidelines for Industrial Property Licensing in Developing Countries met in June 1976. The Working Group examined the draft text of a guide on the legal aspects of the negotiation and preparation of industrial property licenses and technology transfer agreements appropriate to the needs of developing countries, prepared by the International Bureau taking into account the advice of consultants. The Working Group made a number of suggestions to improve the scope, content and presentation of the guide.

43. The final version of the guide is being prepared by the International Bureau on the basis of the discussions in the Working Group and with the assistance of consultants. The guide will be published in the second half of 1977. The guide will be used as a working text for seminars and training courses. In 1979, a working group will be convened to revise the guide in the light of experience and on the basis of proposals to be made by the International Bureau.

44. *Access to and dissemination of works and performances of foreign origin protected by copyright and neighboring rights.*

The International Bureau, in co-operation with national copyright authorities, will undertake in 1977 a study of practical problems, and means of solving them, in securing access to and national publication and dissemination of works of foreign origin, particularly for educational, instructional and scientific purposes. Among the possible means of solving such problems to be included in the study will be the preparation of guidelines on the negotiation of agreements for the dissemination of such works and of standard or model agreements to that effect. The study will also include an examination of the steps taken so far for the implementation of the special provisions regarding developing countries of the Paris Act of the Berne Convention, of any obstacles to such implementation and of practical arrangements which could assist it. A working group will meet in 1978 and 1979 to review the study and to make recommendations to the WIPO Permanent Committee for Development Co-operation Related to Copyright and Neighboring Rights concerning action, including the possible preparation and publication of such guidelines, which could be taken in the field of copyright and neighboring rights, nationally and internationally, in order to promote access to works of foreign origin.

45. *Guide to the Berne Convention.* The International Bureau of WIPO, with the assistance of specialists in international copyright law, will prepare during 1977 the draft of a guide to the Berne Convention on the Protection of Literary and Artistic Works in the form of a commentary on that Convention.

VI. Glossaries and manuals

46. *Industrial property glossary and manual for developing countries.* The manuscripts for an industrial property glossary and manual for developing countries will be prepared by the International Bureau of WIPO in 1977 and 1978. Such a glossary and manual would define the terms most frequently used in industrial property laws and would give general information, for the use of readers in developing countries, on the characteristic aims and essence of industrial property systems, their administration, the procedures to secure industrial property rights in various countries, the typical contractual relations under them, their effect in respect of the disclosure and dissemination of information and international aspects of industrial property relations.

47. *Copyright glossary and manual for developing countries.* The manuscripts for a copyright glossary and manual for developing Countries will be prepared by the secretariats of WIPO and UNESCO, in 1977 and 1978, and printed and published in 1979. Such a glossary and manual would define the terms most frequently used in copyright laws and give general information, for the use of readers in developing countries, on the characteristic aims and essence of copyright laws, their administration, typical contractual relations under them and international aspects of copyright relations.

VII. Studies of legislative and institutional arrangements for the promotion of creative intellectual activity

48. *Promotion of domestic inventive and innovative capacity.* The International Bureau will undertake in 1977 a study of the legislative and institutional, both governmental and private, arrangements which exist in the field of industrial property in developing and developed countries for the promotion of invention, innovation, rationalization and adaptation of technology. A working group will meet in 1978 and 1979 to review the study and to make recommendations to the WIPO Permanent Committee for Development Co-operation Related to Industrial Property concerning action which could be taken in the field of industrial property nationally, regionally and internationally for the strengthening of capabilities for the creation of suitable indigenous technology. A report on this item, prepared by the International Bureau, was submitted to the Permanent Committee at its session in March 1977.

49. *Support of national authors and performers.* The International Bureau will undertake in 1977 a study of the legislative and institutional, both governmental and private, arrangements which exist in the field of copyright and neighboring rights in developing and developed countries for the support of national authors of literary and artistic works (including musical works), performers and other creative artists, including statutory provisions affecting contractual relationships in the absence of specific agreement, standard contractual provisions, advisory boards, fee-collecting societies, etc. A working group will meet in 1978 and 1979 to review the study and to make recommendations to the WIPO Permanent Committee for Development Co-operation Related to Copyright and Neighboring Rights concerning action which could be taken in the field of copyright and neighboring rights nationally and internationally in order to encourage creativity in developing countries.

VIII. Publication of the records of diplomatic conferences and the collection and publication of legislative texts

50. *Records of diplomatic conferences.* The French editions of the *Records of the Washington Diplomatic Conference on the Patent Co-operation Treaty* and the French edition of the *Records of the Vienna Diplomatic Conference on the Trademark Registration Treaty 1973* were published during 1976.

51. Work will continue on the preparation and publication of the records of other diplomatic conferences held in 1974 and 1975, including the records of the International Conference of States on the Distribution of Programme-Carrying Signals Transmitted by Satellite, held at Brussels in 1974.

Legislative texts

52. *Industrial Property Laws and Treaties.* The new legislative series entitled "Industrial Property Laws and Treaties," which began in the February 1976 issue of the monthly review *Industrial Property/La Propriété industrielle,* became available as a separate publication in September 1976. As a complementary service to that monthly review, it consists of a special binder, with contents pages and assembling instructions, in which the detachable legislative texts published in that review may be stored. The service may also be purchased separately. *Industrial Property Laws and Treaties* is divided into three main subject areas—national laws, multinational treaties and bilateral treaties—and the legislative texts are classified accordingly and then subclassified according to country and subject-matter.

53. *Legislation on trademarks.* The International Bureau of WIPO is preparing, according to standard criteria, a summary of selected legislations in the field of trademarks which will be published in the third quarter of 1977. The summary will also serve as background information in the preparatory work for the revision of the Paris Convention (see paragraph 4 above).

54. *Laws and treaties on copyright and neighboring rights.* The collection of laws and treaties on copyright, published in co-operation with UNESCO, and the collection of laws and treaties on neighboring rights, published in co-operation with ILO and UNESCO, will be kept up to date, possibly taking into account the recommendations of a working group on rationalization.

55. *Summary of national legislation in the field of copyright.* The International Bureau will prepare, according to standard criteria, a summary of all national legislation in the field of copyright which will be published in 1977 in tabular form. A report of that summary, together with a comparative study of national legislation prepared by UNESCO, will be published jointly with UNESCO in 1978.

Other legal publications

56. *Periodic reviews.* The International Bureau of WIPO will continue the publication of the periodic reviews *Industrial Property, Copyright* and *Le Propiedad Intelectual* which contain texts of legislative treaties and legal studies as well as notifications on the status of international treaties administered by WIPO.

57. *Authentic and official texts.* In addition, the International Bureau will continue to publish the authentic or official texts

in various languages of the international treaties and the international classifications administered by WIPO, either in the form of brochures or as supplements to the manuals of industrial property conventions and copyright conventions.

IX. Advisory services and training or other assistance in the establishment or strengthening of national or regional institutions

National institutions

58. During 1976, WIPO also received requests from several developing countries for technical co-operation relating to:

(i) the revision of their industrial property legislation or copyright legislation, or specific aspects of it: Algeria (trademarks); Madagascar (industrial property); Mauritius (industrial property and copyright); Niger (copyright); Philippines (industrial property and copyright); Togo (copyright); Tunisia (industrial property); Zaire (industrial property);

(ii) the modernization of their industrial property or copyright administration, or the reorganization of some of their branches: Brazil (UNDP-financed project for the modernization of the patent system); Ecuador (reorganization of the industrial property office); Iraq (trademark system); Madagascar (industrial property administration); Mali (establishment of an industrial property office); Nigeria (industrial property, modernization of the administration); Rwanda (industrial property administration); Sudan (industrial property administration); Togo (copyright administration); Tunisia (industrial property administration); Zaire (industrial property administration);

(iii) training of staff: Cuba (use of the International Patent Classification (IPC)); Senegal (patent licensing questions); Venezuela (industrial property).

59. In most cases, these requests were fulfilled by sending WIPO officials to discuss with the competent authorities of the interested countries the exact scope of their needs and the most suitable manner in which to provide the assistance. In many cases the co-operation that followed consisted in sending experts to assist the competent officials of the country concerned in the implementation of the reorganization or training project which may have been set up for that purpose. Often, some of the responsible officials of the developing country concerned were also offered the opportunity of being trained abroad in the tasks that they would be required to perform as a consequence of the reorganization project, or to see, in practice, how certain situations were solved in other countries.

Regional institutions

60. *African Intellectual Property Organization (OAPI).* At the request of the Director General of OAPI, the International Bureau prepared in January 1976, preliminary draft proposals for the revision of the Libreville Agreement of September 13, 1962, establishing OAPI, including its existing annexes on patents and trademarks, and for the introduction of annexes on utility models, trade names, protection against unfair competition, copyright, and the establishment of a patent documentation and information service. The draft proposals were revised by a Drafting Committee in 1976. The Administrative Council of OAPI, at its session in February 1977, approved the proposals and recommended their acceptance by the member States of OAPI.

61. *Industrial Property Organization for English-Speaking Africa.* A diplomatic conference, convened jointly by the United Nations Economic Commission for Africa (ECA) and WIPO at Lusaka, Zambia, in December 1976, adopted the *Agreement on the Creation of an Industrial Property Organization for English-Speaking Africa.* A draft of that agreement had been prepared by the Conference on Industrial Property Laws of English-speaking Africa at its meeting in Addis Ababa in 1974. The Agreement establishes a regional industrial property organization (hereinafter referred to as "the Organization") for the study and promotion of the co-operation in industrial property matters, including the harmonization and development of industrial property laws, the establishment of common services or organs for the co-ordination, harmonization and development of industrial property activities, and assistance in the acquisition and development of technology relating to industrial property matters. The Agreement calls for the Organization to collaborate with the ECA, WIPO and other appropriate organizations. The organs of the Organization will include a Council, consisting of the heads of offices dealing with the administration of industrial property matters or other persons having requisite knowledge of such matters, and a secretariat. A resolution adopted by the Diplomatic Conference requests the ECA and WIPO, in consultation with the Bureau of the Conference on Industrial Property Laws of English-speaking Africa, to act as the interim secretariat until the secretariat of the Organization is established; it further requests the said Conference to prepare the entry into force of the Agreement.

62. The Agreement, which was unanimously adopted on 9 December 1976, was signed on that day on behalf of the following States: Ghana, Kenya, Mauritius, Somalia, Uganda, Zambia. The Agreement remains open for signature at Lusaka until 31 December 1977. Instruments of ratification or accession are to be deposited with the Government of the Republic of Zambia.

63. Membership of the Organization is open to Botswana, Ethiopia, Gambia, Ghana, Kenya, Lesotho, Liberia, Malawi, Mauritius, Nigeria, the Seychelles, Sierra Leone, Somalia, the Sudan, Swaziland, Uganda, the United Republic of Tanzania and Zambia; other States members of ECA may become members of the Organization on such conditions as its Council may determine.

64. *Advice and assistance in legislation, institutions, and related matters.* At the request of governments and regional organizations, expert services will continue to be made available by the staff of WIPO, with the aid of consultants if necessary, to assist national or regional authorities or interested private circles in developing countries in formulating, revising or harmonizing their legislation on industrial property, copyright and neighboring rights, in establishing or strengthening national or regional institutions concerned with such matters, and in preparing plans for projects on such matters to be financed by UNDP or from other sources and carried out by WIPO, and, where necessary, in organizing meetings for the said purposes.

65. *Functions, Administration and Role of Industrial Property Offices.* A survey will be undertaken in 1977, of the functions, administration and role in the governmental structure of industrial property offices in selected developing and developed countries. At the request of governments of developing countries, and mainly if external financing can be found, fact-finding missions to explore their difficulties and requirements will be undertaken during 1978 and 1979. A report on this item, prepared by the International Bureau, was submitted to the WIPO Permanent Committee for Development Co-operation Related to Industrial Property at its session in March 1977.

Traineeships

66. In co-operation with various industrial property and copyright offices, 38 traineeships for a duration of up to two months were arranged in 1976 for officials from the following 33 countries: Algeria, Benin, Bolivia, Chad, Chile, Colombia, Costa Rica, Cuba, Ecuador, Ethiopia, Fiji, Gambia, Guatemala, India, Indonesia, Iraq, Jordan, Kenya, Madagascar, Malaysia, Mexico, Pakistan, Peru, Philippines, Republic of Korea, Rwanda, Sudan, Tanzania, Thailand, Trinidad and Tobago, Venezuela, Zaire, Zambia. Twenty-nine of these traineeships were awarded in the field of industrial property and 9 in the field of copyright.

67. The training took place at the International Bureau of WIPO in Geneva, at the African Intellectual Property Organization (OAPI) and in the following 16 countries, the Governments of some of which covered fully or in part the costs of the training programme of one to four trainees: Australia, Canada, Czechoslovakia, Egypt, France, Germany, Federal Republic of, Israel, Japan, Mexico, Netherlands, Spain, Sweden, Switzerland, USSR, United Kingdom, United States of America.

The remainder of the costs were borne by the budget of the WIPO Permanent Legal-Technical Programme.

68. A symposium on copyright matters for the benefit of seven of the trainees—from Africa, Chad, Chile, India, Mexico, Philippines, Rwanda—was organized in Geneva, in September 1976, by the International Bureau with the participation of the International Publishers Association (IPA).

69. The training programme will continue to be implemented during 1977.

Regional meetings, seminars, training courses, etc.

70. At least six meetings, seminars or training courses in developing regions, with limited or wider participation, will be organized in each of the years 1977 to 1979. Working documents will be prepared by the International Bureau, in some cases with the assistance of consultants mainly from the regions concerned. Discussion, exchange of experience and training will cover such subjects as: (i) promotion of domestic inventive and innovative capacity; (ii) industrial property office functions and administration; (iii) national application of the new Model Law for Developing Countries on Inventions and Know-how; (iv) administration of trademarks; (v) control of license agreements; (vi) negotiation of license agreements (on the basis of the "Licensing Guide" prepared in 1976 and 1977); (vii) results of the revision of the Paris Convention; (viii) copyright and neighboring rights matters.

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B. CHECK LIST OF UNCITRAL DOCUMENTS

List of documents before the Commission at its tenth session

A. General series

Title or description	*Document reference*
International Sale of Goods: comments by Governments and international organizations on the draft Convention on the International Sale of Goods	A/CN.9/125 and Add.1 to 3
International sale of goods: analysis of comments by Governments and international organizations on the draft Convention on the International Sale of Goods as adopted by the Working Group on the International Sale of Goods: report of the Secretary-General	A/CN.9/126
International commercial arbitration: note by the Secretary-General	A/CN.9/127 and Add.1
Report of the Working Group on the International Sale of Goods on the work of its eighth session (New York, 4-14 January 1977)	A/CN.9/128
Current activities of international organizations related to the harmonization and unification of international trade law: report of the Secretary-General	A/CN.9/129 and Add.1
Security interests: report of the Secretary-General	A/CN.9/130
International payments: study on security interests: report of the Secretary-General	A/CN.9/131
Security interests: security interests in the United States of America: note by the Secretariat on article 9 of the Uniform Commercial Code	A/CN.9/132
Liability for damage caused by products involved in international trade: report of the Secretary-General	A/CN.9/133
Provisional agenda, annotations thereto, and tentative schedule of meetings: note by the Secretary-General	A/CN.9/134
International sale of goods: draft Convention on the International Sale of Goods: draft articles concerning implementation and other final clauses: report of the Secretary-General	A/CN.9/135
General conditions of sale and standard contracts: report of the Secretary-General	A/CN.9/136
Training and assistance in the field of international trade law: note by the Secretary-General	A/CN.9/137
Consistency of legal provisions drafted by the Commission or its working groups: note by the Secretariat	A/CN.9/138
Liability for damage caused by products involved in international trade: analysis of the replies of Governments to the questionnaire on liability for damage caused by products: report of the Secretary-General	A/CN.9/139

Title or description	*Document reference*
Possible conference of plenipotentiaries to conclude a Convention on the International Sale of Goods: financial implications: note by the Secretary-General	A/CN.9/140

B. Restricted series

Plenary

Proposed schedule of meetings	A/CN.9/X/CRP.1
Report of Committee of the Whole II: introduction	A/CN.9/X/CRP.2
Draft report of the United Nations Commission on International Trade Law on the work of its tenth session	A/CN.9/X/CRP.3 and Add.1 to 4

Draft Convention on the International Sale of Goods

Committee of the Whole I

Article 2, amendment proposed by Finland	A/CN.9/X/C.1/CRP.1
Article 2, proposal by the Federal Republic of Germany	A/CN.9/X/C.1/CRP.2
Articles 1 and 4, proposal by Hungary	A/CN.9/X/C.1/CRP.3
Articles 10 and 11, proposals by the Union of Soviet Socialist Republics	A/CN.9/X/C.1/CRP.4
Proposals by the International Chamber of Commerce	A/CN.9/X/C.1/CRP.5
New article 13, proposal by the German Democratic Republic	A/CN.9/X/C.1/CRP.6
Article 10, proposal by the German Democratic Republic	A/CN.9/X/C.1/CRP.7
Article 13, proposal by the Union of Soviet Socialist Republics	A/CN.9/X/C.1/CRP.8
Article 13, proposal by the Federal Republic of Germany	A/CN.9/X/C.1/CRP.9
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