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Commission on
International
Trade Law**

YEARBOOK

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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.

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INTRODUCTION

This is the sixteenth volume in the series of Yearbooks of the United Nations Commission on International Trade Law (UNCITRAL).¹

The present volume consists of three parts. Part one contains the Commission's report on the work of its eighteenth session, which was held in Vienna from 3 to 21 June 1985, and the action thereon by the United Nations Conference on Trade and Development (UNCTAD) and by the General Assembly.

Part two reproduces most of the documents considered at the eighteenth session of the Commission. These documents include reports of the Commission's Working Groups dealing, respectively, with international negotiable instruments, the new international economic order, and international contract practices, as well as reports and notes by the Secretary-General and the Secretariat. Also included in this part are selected working papers which were before the Working Groups.

Part three contains the UNCITRAL Model Law on International Commercial Arbitration, which was adopted at the eighteenth session of the Commission, summary records of selected Commission meetings, a bibliography of recent writings related to the Commission's work, prepared by the secretariat, a check-list of UNCITRAL documents, and a list of cross-references to UNCITRAL documents referred to in this volume.

¹To date, the following volumes of the *Yearbook of the United Nations Commission on International Trade Law* [abbreviated herein as *Yearbook* (year)] have been published:

Volume	Years covered	United Nations Publication Sales No.
I	1968-1970	E.71.V.1
II	1971	E.72.V.4
III	1972	E.73.V.6
III (Supplement)	1972	E.73.V.9
IV	1973	E.74.V.3
V	1974	E.75.V.2
VI	1975	E.76.V.5
VII	1976	E.77.V.1
VIII	1977	E.78.V.7
IX	1978	E.80.V.8
X	1979	E.81.V.2
XI	1980	E.81.V.8
XII	1981	E.82.V.6
XIII	1982	E.84.V.5
XIV	1983	E.85.V.3
XV	1984	E.86.V.2

THE EIGHTEENTH SESSION (1985)

A. Report of the United Nations Commission on International Trade Law on the work of its eighteenth session (Vienna, 3-21 June 1985) (A/40/17)^a

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^aOfficial Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17) (hereinafter referred to as *Report*).

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Introduction

1. The present report of the United Nations Commission on International Trade Law covers the Commission's eighteenth session, held at Vienna from 3 to 21 June 1985.

2. Pursuant to General Assembly resolution 2205 (XXI) of 17 December 1966, this report is submitted to the 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 eighteenth session on 3 June 1985. The session was opened on behalf of the Secretary-General by Mr. Carl-August Fleischhauer, Under-Secretary-General, 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 9 November 1979 and 15 November 1982, are the following States:¹ Algeria,** Australia,** Austria,** Brazil,** Central African Republic,** China,** Cuba,* Cyprus,* Czechoslovakia,*

¹Term of office expires on the day before the opening of the regular session of the Commission in 1986.

²Term of office expires on the day before the opening of the regular session of the Commission in 1989.

³Pursuant to General Assembly resolution 2205 (XXI), the members of the Commission are elected for a term of six years. Of the current membership, 19 were elected by the Assembly at its thirty-fourth session on 9 November 1979 (decision 34/308) and 17 were elected by the Assembly at its thirty-seventh session on 15 November 1982 (decision 37/308). Pursuant to resolution 31/99 of 15 December 1976, the term of those members elected by the Assembly at its thirty-fourth session will expire on the last day prior to the opening of the nineteenth regular annual session of the Commission in 1986, while the term of those members elected by the Assembly at its thirty-seventh session will expire on the last day prior to the opening of the twenty-second regular annual session of the Commission in 1989.

Egypt,** France,** German Democratic Republic,** Germany, Federal Republic of,* Guatemala,* Hungary,* India,* Iraq,* Italy,* Japan,** Kenya,* Mexico,** Nigeria,** Peru,* Philippines,* Senegal,* Sierra Leone,* Singapore,** Spain,* Sweden,** Trinidad and Tobago,* Uganda,* Union of Soviet Socialist Republics,** United Kingdom of Great Britain and Northern Ireland,** United Republic of Tanzania,** United States of America* and Yugoslavia.*

5. With the exception of the Central African Republic, Senegal, Trinidad and Tobago and Uganda, all members of the Commission were represented at the session.

6. The session was also attended by observers from the following States: Argentina, Bulgaria, Byelorussian Soviet Socialist Republic, Canada, Chile, Colombia, Côte d'Ivoire, Democratic People's Republic of Korea, Dominican Republic, Finland, Greece, Guinea, Holy See, Indonesia, Iran (Islamic Republic of), Kuwait, Lebanon, Netherlands, Norway, Oman, Panama, Poland, Portugal, Republic of Korea, Romania, Switzerland, Thailand, Ukrainian Soviet Socialist Republic, Venezuela and Zaïre.

7. The following international organizations were represented by observers:

(a) *United Nations Secretariat*

Economic Commission for Europe (ECE)
United Nations Conference on Trade and Development (UNCTAD)
United Nations Industrial Development Organization (UNIDO)

* * *

International Trade Centre (UNCTAD/GATT)

(b) *Intergovernmental organizations*

Asian-African Legal Consultative Committee
Bank for International Settlements
Commission of the European Communities
Council of Europe
Hague Conference on Private International Law
International Institute for the Unification of Private Law

(c) *Other international organizations*

Chartered Institute of Arbitrators
Inter-American Bar Association

Inter-American Commercial Arbitration Commission
 International Bar Association
 International Chamber of Commerce
 International Council for Commercial Arbitration
 International Federation of Consulting Engineers
 Regional Centre for Commercial Arbitration,
 Cairo

C. Election of officers

8. The Commission elected the following officers:²

Chairman: R. Loewe (Austria)
 Vice-Chairmen: L. G. Paes de Barros Leaes (Brazil)
 I. Szasz (Hungary)
 H. Z. Tang (China)
 Rapporteur: E. E. E. Mtango (United Republic
 of Tanzania)

D. Agenda

9. The agenda of the session, as adopted by the Commission at its 305th meeting on 3 June 1985, was as follows:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. International commercial arbitration.
5. International payments.
6. New international economic order: industrial contracts.
7. Operators of transport terminals.
8. Co-ordination of work.
9. Status of conventions.
10. Dissemination of decisions concerning UNCITRAL legal texts and uniform interpretation of such texts.
11. Training and assistance.
12. General Assembly resolution on the work of the Commission.
13. Future work.
14. Other business.
15. Adoption of the report of the Commission.

E. Adoption of the report

10. The Commission adopted the present report at its 333rd and 334th meetings, on 21 June 1985, by consensus.

²The elections took place at the 305th and 308th meetings, on 3 and 4 June 1985. 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 report of the United Nations Commission on International Trade Law on the work of its first session, *Official Records of the General Assembly, Twenty-third Session, Supplement No. 16 (A/7216)*, para. 14 (*Yearbook 1968-1970, part two, 1, A, para. 14*)).

Chapter II. International commercial arbitration: draft model law on international commercial arbitration³

A. Introduction

11. The Commission, at its fourteenth session, decided to entrust the Working Group on International Contract Practices with the task of preparing a draft model law on international commercial arbitration.⁴ The Working Group carried out its task at its third, fourth, fifth, sixth and seventh sessions.⁵ The Working Group completed its work by adopting the draft text of a model law on international commercial arbitration at the close of the seventh session,⁶ after a drafting group had established corresponding language versions in the six languages of the Commission.

12. The Commission, at its seventeenth session, requested the Secretary-General to transmit the draft text to all Governments and interested international organizations for their comments and requested the secretariat to prepare an analytical compilation of the comments received. The Commission also requested the secretariat to submit to the eighteenth session of the Commission a commentary on the draft text.⁷

13. At its current session, the Commission had before it a report of the Secretary-General containing an analytical compilation of comments by Governments and international organizations on the draft text of a model law on international commercial arbitration (A/CN.9/263 and Add. 1 and 2) and a report of the Secretary-General containing an analytical commentary on the draft text (A/CN.9/264).

B. General observations on the draft text of a model law on international commercial arbitration

14. The Commission reaffirmed its appreciation to the Working Group on International Contract Practices for having elaborated the draft text of a model law on international commercial arbitration, which was in general favourably received and regarded as an excellent basis for the deliberations of the Commission.

15. It was stated that the paramount consideration in reviewing and revising the draft text should be the efficient functioning of international commercial arbitration.

³The Commission considered this subject at its 305th to 333rd meetings, on 3 to 21 June 1985. Summary records of those meetings are contained in A/CN.9/SR.305-333.

⁴Report of the United Nations Commission on International Trade Law on the work of its fourteenth session, *Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17)*, para. 70.

⁵Reports on the work of those sessions are contained in A/CN.9/216, A/CN.9/232, A/CN.9/233, A/CN.9/245 and A/CN.9/246.

⁶The draft text of a model law on international commercial arbitration is contained in the annex to A/CN.9/246.

⁷Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth session, Supplement No. 17 (A/39/17)*, para. 101.

tration. To that end, due account must be taken of the needs of those who in day-to-day practice would use the text and whom it was ultimately intended to serve.

16. As regards the future form of the text to be adopted, the Commission decided to maintain the working assumption of the Working Group, according to which the text would be adopted and recommended in the form of a model law and not in that of a convention, subject to possible review of that decision at the end of its deliberations on the substance of the draft text.

C. Discussion on individual articles of the draft text

CHAPTER I. GENERAL PROVISIONS

Article 1.

*Scope of application**

17. The text of article 1 as considered by the Commission was as follows:

"(1) This Law applies to international commercial** arbitration, subject to any multilateral or bilateral agreement which has effect in this State.

"(2) An arbitration is international if:

"(a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States; or

"(b) one of the following places is situated outside the State in which the parties have their places of business:

"(i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;

"(ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or

"(c) the subject-matter of the arbitration agreement is otherwise related to more than one State.

"(3) For the purposes of paragraph (2) of this article, if a party has more than one place of business, the relevant place of business is that which has the closest relationship to the arbitration agreement. If a party does not have a place of business, reference is to be made to his habitual residence."

*Article headings are for reference purposes only and are not to be used for purposes of interpretation.

**The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business co-operation; carriage of goods or passengers by air, sea, rail or road."

Substantive scope of application: international commercial arbitration

18. While some concern was expressed about restricting the substantive scope of application to international commercial matters, the Commission was agreed that the draft text should be geared to and cover only international commercial arbitration.

The term "commercial"

19. Divergent views were expressed as to the appropriateness of the footnote accompanying paragraph (1) as regards its form as well as its content, although it was generally agreed that the term "commercial" should be given a wide interpretation. Under one view, the footnote should be deleted since in many legal systems, in particular those which did not use the technique of a footnote, it would be without legal value. Instead, an attempt should be made to define the term "commercial" in the body of the law itself. Such a definition might, for example, be based on a shortened version of the text contained in the footnote or by a reference in article 1 (1) to disputes arising from trade or commerce. An alternative suggestion was to present the guideline for interpretation, contained in the footnote, in a commentary or in the report on the proceedings.

20. The prevailing view was that the footnote should be retained, though possibly with certain modifications. It was realized that no generally acceptable definition had been found to date and that any definition would entail certain risks. It was felt that the footnote, despite its uncertain legal effect, could provide useful guidance in interpretation, at least to the drafters of any national enactment of the model law.

21. A number of modifications were proposed to the text of the footnote, whether the text would be retained in a footnote or incorporated into the body of the law itself. One proposal was to clarify that, in line with article 7 (1), non-contractual relationships were included, since the term "transaction" might lead to the opposite result. Other proposals were to add to the list of examples such commercial activities as services and processing as well as agreements on international economic co-operation.

22. In view of the fact that certain national laws of civil law tradition drew the line between commercial and civil transactions according to whether or not the parties involved were commercial persons (merchants), there was support for the proposal to state in the opening sentence that the qualification of a relationship as commercial did not depend on the nature or character of the parties. That proposal was objected to on the ground that such wording might be construed as touching upon the sensitive issue of State immunity. The Commission was agreed that there was no intention to deal with that issue in the Model Law and that, if the proposal were to be accepted, it would have to be made clear that rules on State immunity were not affected. Another concern was that the illustrative list of commercial relationships could be construed as

meaning in positive terms that any dispute arising therefrom would be capable of settlement by arbitration. As to a decision relating to that concern, see below, para. 29.

23. The Commission established an *ad hoc* working party composed of the representatives of China, Hungary and the United States and requested it to prepare, in the light of the above discussion and proposals, a revised version of paragraph (1) and the accompanying footnote for consideration by the Commission.

24. The *ad hoc* working party suggested replacing, in article 1 (1), the words "international commercial** arbitration" by the words "international arbitration in commercial** matters, including services and other economic relations". It also suggested revising the opening part of the footnote as follows: "***The term 'commercial' should be given a wide interpretation so as to include, but not be limited to, the following: any trade transaction for the supply or exchange of goods or services; distribution agreement; . . .".

25. It was noted that the proposed text did not use the term "international commercial arbitration", which had come to be a well-known term in the field. After discussion, the Commission decided that, in spite of the acknowledged difficulties, it would be better to retain the original text of article 1 (1) and to revise the footnote as follows: "***The term 'commercial' should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply of goods or services; distribution agreement; . . .".

26. The Commission was of the view that with the revision of the footnote it was sufficiently clear that the qualification of a relationship as commercial did not depend on the nature of the parties. Therefore, it was felt that it was not necessary to express it explicitly in the text either of article 1 (1) or of the footnote. The Commission was also of the view that the provision as drafted did not touch on any rule on sovereign immunity.

Paragraph (2): "international"

27. The Commission adopted subparagraph (a) and was agreed that the provision would cover the bulk of cases encountered in international commercial arbitration.

28. Divergent views were expressed as to the appropriateness of retaining subparagraph (b) (i). Under one view, the provision should be deleted for essentially two reasons. One reason was that there was no justification to qualify a purely domestic relationship as international simply because a foreign place of arbitration was chosen. Party autonomy was unacceptable here since it would enable parties to evade mandatory provisions of law, including those providing for exclusive court jurisdiction, except where recognition or enforce-

ment of the "foreign" award was later sought in that State. The other reason was that the provision covered not only the case where the place of arbitration was determined in the arbitration agreement but also the case where it was determined only later, pursuant to the agreement, for example by an arbitral institution or the arbitral tribunal. It was felt that the latter case created uncertainty as to what was the applicable law and as to the availability of court services before the place of arbitration was determined. Under another view, only the latter reason was convincing and, therefore, subparagraph (b) (i) should be maintained without the words "or pursuant to".

29. The prevailing view was to retain the entire provision of subparagraph (b) (i). It was noted that the provision only addressed the question of internationality, i.e. whether the (Model) Law for international cases or the same State's law for domestic cases applied. It was thought that the principle of party autonomy should extend to that question. The Commission, in adopting that view, was agreed, however, that the concern relating to non-arbitrability, which had also been raised in a more general sense and in particular in the discussion on paragraph (1) and the accompanying footnote (above, para. 22), should be met by a clarifying statement in a separate paragraph of article 1 along the following lines: "This Law does not affect any other law of this State which provides that a certain dispute or subject-matter is not capable of settlement by arbitration."

30. As regards subparagraphs (b) (ii) and (c), the Commission was agreed that their respective scope was not easily determined in a clear manner. In particular, subparagraph (c) was regarded as unworkable due to its vague ambit. While there was some support for maintaining the provision, though possibly in some modified form, the Commission, after deliberation, decided to delete subparagraph (c).

31. However, in order to balance the reduction in scope due to that deletion, it was proposed to add an opting-in provision, either only to subparagraph (b) (ii) or as a replacement for subparagraph (c). It was thought that such a provision provided a more precise test than the one set forth in subparagraph (c). In response to that proposal, a concern was expressed that such a subjective criterion would enable parties freely to label as international a purely domestic case. Others, however, considered that any such concern was outweighed by the advantages of a system that provided certainty to the parties that their transaction would be recognized as international, a characterization that should properly fall within the scope of party autonomy. In response to that consideration the view was expressed that it was inconceivable that any State which deemed it necessary to retain a special law for domestic cases would want to allow parties to evade that system.

32. The Commission requested an *ad hoc* working party, composed of the representatives of Australia, Finland, India, the Union of Soviet Socialist Republics and the United States, to prepare a draft of an opting-in

provision and of a provision to implement the proposal on non-arbitrability. The working party was also requested to prepare, for consideration by the Commission, a draft provision which would express the character of the Model Law as a *lex specialis* with regard to all matters governed by the Law.

33. As to the opting-in provision, the *ad hoc* working party suggested replacing the wording in subparagraph (c) by the following new provision: "(c) The parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one country." While the concern previously expressed above in paragraph 31 was restated, it was pointed out that courts were unlikely to give effect to such an agreement in a purely domestic case. After discussion, the Commission adopted the suggested provision.

34. As to the provision on non-arbitrability, the *ad hoc* working party suggested adding the following new paragraph to article 1: "This Law shall not affect any other law of this State by virtue of which certain disputes may not be submitted to arbitration or may be submitted to arbitration only according to provisions other than those of this Law." The Commission adopted the suggested paragraph.

35. As to the provision expressing the *lex specialis* character of the Model Law, the *ad hoc* working party suggested adding the following new paragraph to article 1: "This Law prevails over other provisions of law of this State as to matters governed by this Law." The Commission decided not to include the suggested formulation in article 1 because of a concern that the proposed provision linked a somewhat imprecise delimitation of "matters governed by this Law" with a categorical rule. However, it was understood that, since the Model Law was designed to establish a special legal régime, in case of conflict, its provisions, rather than those applicable to arbitrations in general, would apply to international commercial arbitrations.

Paragraph (3)

36. The Commission adopted the provision, subject to the deletion of the word "relevant" and to clarifying that the second sentence did not relate to the first sentence but to paragraph (2).

* * *

Article 2.

Definitions and rules of interpretation

37. The text of article 2 as considered by the Commission was as follows:

"For the purposes of this Law:

"(a) 'arbitral tribunal' means a sole arbitrator or a panel of arbitrators;

"(b) 'court' means a body or organ of the judicial system of a country;

"(c) where a provision of this Law leaves the parties free to determine a certain issue, such

freedom includes the right of the parties to authorize a third party, including an institution, to make that determination;

"(d) where a provision of this Law refers to the fact that the parties have agreed or that they may agree or in any other way refers to an agreement of the parties, such agreement includes any arbitration rules referred to in that agreement;

"(e) unless otherwise agreed by the parties, any written communication is deemed to have been received if it is delivered to the addressee personally or if it is delivered at his place of business, habitual residence or mailing address, or, if none of these can be found after making reasonable inquiry, then at the addressee's last-known place of business, habitual residence or mailing address. The communication shall be deemed to have been received on the day it is so delivered."

Subparagraphs (a), (b) and (d)

38. The Commission adopted subparagraphs (a), (b) and (d) of the article.

Subparagraph (c)

39. During the discussion on subparagraph (c), a suggestion was made to express by an appropriate reservation that the freedom of the parties to authorize a third person to make a certain determination did not extend to the determination of the rules of law applicable to the substance of the dispute, as referred to in article 28 (1). The Commission postponed consideration of the suggestion until the discussion of article 28.

40. In accordance with the view of the Commission expressed during the subsequent discussion on article 28 that the Model Law should not deal with the possibility that parties might authorize a third person to determine rules of law applicable to the substance of the dispute (see below, para. 242), the Commission decided to modify subparagraph (c) along the following lines: "(c) where a provision of this Law, except article 28, leaves the parties free to determine a certain issue, such freedom includes the right of the parties to authorize a third party, including an institution, to make that determination".

Subparagraph (e)

41. In respect of subparagraph (e), several suggestions were made for adding certain procedural rules, in particular as regards the case where the addressee's place of business, habitual residence or mailing address was not to be found. One suggestion, which the Commission adopted, was to clarify that in such case the mailing by registered letter sufficed. The Commission did not accept a suggestion to lay down certain criteria for determining what constituted a reasonable inquiry. Another submission, with which the Commission agreed, was that the expression "last-known" referred to the knowledge of the sender.

42. In order to reduce the risk that the provision might operate to the detriment of a party who was unaware of any proceedings against him, it was suggested that some sort of advertising should be required, a certain period of time should be established for the fictitious receipt to become effective or that some possibility for the respondent to resort to a court should be envisaged. Another suggestion was not to retain the provision and to rely solely on the requirements and safeguards of the applicable procedural law. Yet another suggestion was that the provision, since it went clearly beyond a mere definition or rule of interpretation, should be placed in a separate article of the Model Law.

43. The Commission, after deliberation, was agreed that the provision should not set forth excessively detailed procedural requirements which could prove to be an obstacle to incorporating the Model Law in national legal systems. The Commission entrusted an *ad hoc* working party, composed of the representatives of Czechoslovakia, Iraq and Mexico, to prepare a modified version of the provision in the light of the above discussion.

44. The *ad hoc* working party suggested placing the provision in a new article 3 in the following modified form:

"(1) Unless otherwise agreed by the parties, any written communication is deemed to have been received if it is delivered to the addressee personally or if it is delivered at his place of business, habitual residence or mailing address; if none of these can be found after making reasonable inquiry, a written communication is deemed to have been received if it is sent to the addressee's last-known place of business, habitual residence or mailing address by registered letter or any other means which provides a record of the attempt to deliver it.

"(2) The communication is deemed to have been received on the day it is so delivered."

45. The Commission adopted the suggested provision as new article 3. It was noted that the reason for placing the provision in a separate article was that it contained a rule of procedure and neither a definition nor a rule of interpretation. It was also noted that the reason for placing the last sentence in a separate paragraph was to make clear that the sentence referred to the entire provision. As to the understanding of the Commission that new article 3 on receipt of communications did not apply to court proceedings or measures but only to the arbitral proceedings proper, see below, para. 106.

Suggestions for additional definitions

46. The Commission adopted the proposal to express in article 2, possibly before the definition of "arbitral tribunal" in subparagraph (a), that the term "arbitration" meant any arbitration whether or not administered by a permanent arbitral institution.

47. The Commission did not accept a proposal to move the definition of "arbitration agreement", set forth in article 7 (1), to article 2.

48. It was suggested that the term "award" should be defined in the Model Law. Such a definition, which would be useful for all provisions where the term was used, could also clarify the various possible types of awards, such as final, partial, interim or interlocutory awards.

49. The Commission was agreed that, while a definition was desirable, a more modest approach should be taken in view of the considerable difficulty of finding an acceptable definition and in view of the fact that other legal texts on arbitration, e.g. the 1958 New York Convention and many national laws, did not define the term. It was agreed to determine in the context of article 34 and any other provision where such determination was needed (e.g. articles 31 and 33) which types of decisions were covered by those articles.

50. As to a decision to add a new subparagraph (f) in respect of counter-claims, see below, para. 327.

* * *

Article 4.

Waiver of right to object

51. The text of article 4 as considered by the Commission was as follows:

"A party who knows or ought to have known that any provision of this Law from which the parties may derogate or any requirement under the arbitration agreement has not been complied with and yet proceeds with the arbitration without stating his objection to such non-compliance without delay or, if a time-limit is provided therefor, within such period of time, shall be deemed to have waived his right to object."

52. Divergent views were expressed as to whether article 4 should be retained. Under one view, the provision was too vague and possibly in conflict with relevant provisions of national law and, as regards its effect, too rigid in that it might operate unfairly against a party. For those reasons, the question of waiver or estoppel should either be left entirely to the applicable national law or, if it was deemed absolutely necessary to have a waiver rule in regard to certain provisions, the question should be addressed only in the individual articles of the Model Law concerning those provisions.

53. The prevailing view, which the Commission adopted, was that a general waiver rule along the lines of article 4 should be maintained, since such a rule would help the arbitral process function efficiently and in good faith and would help achieve greater uniformity in the matter.

54. As regards the contents of article 4, various suggestions were made. It was suggested that, as to the imputed knowledge of a party, the wording "or ought to have known" should either be deleted or be made more precise and less rigid by requiring ordinary care or reasonable diligence. Noting that those words were not contained in the corresponding provision in the

UNCITRAL Arbitration Rules (article 30), the Commission decided to delete them since they might create more problems than they solved.

55. A suggestion was made to delete the reference to the non-mandatory provisions of law and the arbitration agreement. The Commission did not adopt the proposal since the remaining provision would be too vague and, since it would also cover non-compliance with mandatory provisions of law, it would be too rigid.

56. The view was expressed that the words "without delay" were too vague and too rigid. It was, therefore, proposed to establish instead a period of time or to soften the requirement by using wording such as "within reasonable time". It was noted, in that context, that the time element was important in view of the fact that a period of time as referred to in article 4 was not contained in any provision of the Model Law and was rarely contained in arbitration agreements. The Commission, after deliberation, decided to use the wording "without undue delay" instead of fixing a period of time, since no period of time could be appropriate in all cases.

57. As regards the effect of a waiver under article 4, the Commission was agreed that it was not limited to the arbitral proceedings but extended to subsequent court proceedings in the context of articles 34 and 36. It was noted, however, that where an arbitral tribunal had ruled that a party was deemed to have waived his right to object, the court could come to a different conclusion in its review of the arbitral procedure under article 34 or, provided the proceedings were conducted under the Model Law, article 36.

* * *

Article 5.

Scope of court intervention

58. The text of article 5 as considered by the Commission was as follows:

"In matters governed by this Law, no court shall intervene except where so provided in this Law."

59. Divergent views were expressed as to the appropriateness of the provision. The discussion focused on two objections. The first objection was that the provision, which addressed an issue of fundamental practical importance, did not give a clear answer to the question whether in a given situation court intervention was available or excluded. The second objection was that the provision, read together with the few provisions of the Model Law which provided for court intervention, presented an unacceptably restrictive scope of judicial control and assistance.

60. In advancing the first objection, it was pointed out that in many cases it was not possible to know whether a matter was governed by the Law. If a particular matter was not expressly mentioned in the Law, it was possible that the drafters had considered the matter and decided that the Law should not cover it, that the

drafters had considered the matter and decided not to give the court authority to intervene or that the drafters had failed to consider the matter at all. Especially since the parties, arbitral tribunals and courts who would be called upon to apply the Law in the future would not have easy access to the drafting history, they would often not know into which category a particular matter fell.

61. In response to that objection, it was pointed out that the problem was common to any *lex specialis* and, in fact, all texts for the unification of law. Since no such text was complete in every respect, what was not governed by it must be governed by the other rules of domestic law. Therefore, it was necessary, though admittedly often difficult, to determine the scope of coverage of the particular text. Yet, in the great majority of cases in which the question of court intervention became relevant, the answer could be found by using the normal rules of statutory interpretation, taking into account the principles underlying the text of the Model Law.

62. In advancing the second objection, it was emphasized that article 5 expressed an excessively restrictive view as to the desirability and appropriateness of court intervention during an arbitration. It was to the advantage of businessmen who engaged in international commercial arbitration to have access to the courts while the arbitration was still in process in order to stop an abuse of the arbitral procedure. Furthermore, a limitation of the authority of the courts to intervene in arbitral proceedings might constitute an unwarranted interference in the prerogatives of the judicial power, and might even be contrary to the constitution in some States. Finally, even if the authority of the court to intervene in supervision of an arbitration might have to be limited, the court should have a broader power to act in aid of the arbitration. It was suggested, as a possible means of softening the extremely rigid character of article 5, to give the parties to an arbitration the authority to agree on a more extensive degree of court supervision and assistance in their arbitration than was furnished by the Model Law.

63. In response to that second objection, it was pointed out that resort to intervention by a court during the arbitral proceedings was often used only as a delaying tactic and was more often a source of abuse of the arbitral proceedings than it was a protection against abuse. The purpose of article 5 was to achieve certainty as to the maximum extent of judicial intervention, including assistance, in international commercial arbitrations, by compelling the drafters to list in the (Model) Law on international commercial arbitration all instances of court intervention. Thus, if a need was felt for adding another such situation, it should be expressed in the Model Law. It was also recognized that, although the Commission might hope that States would adopt the Law as it was drafted, since it was a model law and not a convention, any State which might have constitutional problems could extend the scope of judicial intervention when it adopted the Law without violating any international obligation.

64. As regards the suggestion to enable parties to agree on a wider scope of court intervention, the question was raised as to whether the parties could be expected to draft an agreement on the point that would adequately deal with the problems. Moreover, the concern was expressed that institutional arbitration rules might include a provision extending the right of court intervention and that some parties who had agreed to the use of those rules might be subject to court intervention they had not expected.

65. The Commission, after deliberation, adopted the article in its current form.

* * *

Article 6.

Court for certain functions of arbitration assistance and supervision

66. The text of article 6 as considered by the Commission was as follows:

"The Court with jurisdiction to perform the functions referred to in articles 11 (3), (4), 13 (3), 14 and 34 (2) shall be the . . . (blanks to be filled by each State when enacting the Model Law)."

67. The Commission was agreed that article 6, by calling upon each State to designate a court for performing the functions of arbitration assistance and supervision referred to in the article, was useful and beneficial to international commercial arbitration. As a result of a subsequent decision to provide for instant court control over an arbitral tribunal's ruling that it had jurisdiction (see below, para. 161), a reference to article 16 (3) was included in article 6.

68. It was understood that a State was not compelled to designate merely one single court but was free to entrust a number of its courts or a certain category of its courts with performing those functions. That point could be made clear by adding to the words "the Court" the words "or the Courts".

69. It was also agreed that a State should not be compelled to designate a court in the terms of article (2) (b) for all the functions referred to in article 6 but should be free to entrust the functions envisaged in articles 11, 13 and 14 to an organ or authority outside its judicial system such as a chamber of commerce or an arbitral institution.

70. A suggestion was made to recognize party autonomy as regards the choice of the forum in those cases where more than one court was competent to perform the functions of arbitration assistance and supervision. Another suggestion was to resolve any possible positive conflict of court competence by according priority to the court first seized with the matter. The Commission did not accept those suggestions since, in so far as the choice of forum within a given State was concerned, the issue fell in the national domain of regulating the organization of and access to its courts and, in so far as the issue and possible conflict of the competence of

courts in different States was concerned, it could not effectively be settled by a model law.

71. The Commission was agreed, however, that it was desirable to determine the instances in which the court or courts of a particular State which had adopted the Model Law would be competent to perform the functions referred to in article 6. It was noted that the question was directly related to the general matter of the territorial scope of application of the Model Law. The Commission, therefore, embarked on a discussion of that general matter.

Discussion on territorial scope of application

72. Divergent views were expressed as to whether the Model Law should expressly state its territorial scope of application and, if so, which connecting factor should be the determining criterion. Under one view, it was inappropriate to determine that issue in the Model Law since the territorial scope of application of the Law as adopted in a given State was either self-evident from the fact of its enactment or was to be determined by the particular State in accordance with its general policies in that regard, including its stance on conflict of laws and on court competence. The prevailing view, however, was that it was desirable to determine that issue in the Model Law in order to achieve a greater degree of harmony, thereby helping to reduce the conflict of laws as well as of court competence.

73. As regards the connecting factor which should determine the applicability of the (Model) Law in a given State, there was wide support for the so-called strict territorial criterion, according to which the Law would apply where the place of arbitration was in that State. In support of that view, it was pointed out that that criterion was used by the great majority of national laws and that, where national laws allowed parties to choose the procedural law of a State other than that where the arbitration took place, experience showed that parties in practice rarely made use of that faculty. The Model Law, by its liberal contents, further reduced the need for such choice of a "foreign" law in lieu of the (Model) Law of the place of arbitration; it was pointed out that the Model Law itself allowed the parties wide freedom in shaping the rules of the arbitral proceedings, including the faculty of agreeing on the procedural provisions of a "foreign" law so long as they did not conflict with the mandatory provisions of the Model Law.

74. Another view was that the place of arbitration should not be exclusive in the sense that parties would be precluded from choosing the law of another State as the law applicable to the arbitration procedure. A State which adopted the Model Law might wish to apply it also to those cases where parties had chosen the law of that State even though the place of arbitration was in a different State. It was recognized that such choice might be subject to certain restrictions, in particular as regards fundamental notions of justice, reasons of public policy and rules of court competence intrinsic to the legal and judicial system of each State.

75. The Commission was agreed that the basic criterion for the territorial scope of application, whatever its precise final wording, would not govern the court functions envisaged in articles 8 (1), 9, 35 and 36, which were entrusted to the courts of the particular State adopting the Model Law irrespective of where the place of arbitration was located or under which law the arbitration was conducted.

76. As regards the court functions referred to in article 6, i.e. those envisaged in articles 11 (3), 11 (4), 13 (3), 14 and 34 (2), it was agreed that a decision should be made in the context of the discussion on each of those articles whether the basic criterion would be appropriate. In that connection, it was suggested that an extension of the territorial scope of application might be desirable with regard to the court functions envisaged in articles 11, 13 and 14 so as to make available the assistance of the court specified in article 6 even before the place of arbitration or other general connecting factor for the applicability of the (Model) Law of a particular State had been established. Various suggestions were made as to which should be the special connecting factor for that purpose: (a) defendant has place of business in this State; (b) claimant has place of business in this State; (c) claimant or defendant has place of business in this State; (d) arbitration agreement was concluded in this State; (e) for certain instances: place of residence of arbitrator concerned is in this State.

77. While some doubts were expressed as to the practical need for and feasibility of such an extension, others felt that such a need existed in many cases. The Commission was agreed that the question should be decided in the context of its discussion of the relevant articles (i.e. articles 11, 13 and 14).

78. The Commission requested the secretariat to prepare, on the basis of the above discussion, draft provisions on the territorial scope of application of the Model Law in general, including suggestions as to possible exceptions to the general scope.

79. The secretariat prepared the following draft of a new paragraph (1 *bis*) of article 1 for consideration by the Commission:

"(1 *bis*) The provisions of this Law apply if the place of arbitration is in the territory of this State. However, those provisions on functions of courts of this State set forth in articles 8, 9, 35 and 36 apply irrespective of whether the place of arbitration is in the territory of this State; those provisions on functions of courts of this State set forth in articles 11, 13 and 14 apply even where the place of arbitration is not yet determined, provided that the respondent [or the claimant] has his place of business in the territory of this State."

The secretariat added the suggestion that, if the Commission were to decide that the court assistance envisaged in articles 11, 13 and 14 need not be made available in those cases where the place of arbitration was not yet determined, the following short version of paragraph (1 *bis*) might be sufficient:

"(1 *bis*) The provisions of this Law, except articles 8, 9, 35 and 36, apply if the place of arbitration is in the territory of this State."

80. In discussing the above proposal, the Commission decided that, for reasons stated in support of the strict territorial criterion (see above, para. 73), the applicability of the Model Law should depend exclusively on the place of arbitration as defined in the Model Law. As to the question of extending the applicability of articles 11, 13 and 14 to the time before the place of arbitration was determined, some support was expressed for such an extension since it was important to provide court assistance in the cases where parties could not reach an agreement on the place of arbitration. However, the prevailing view was that the Model Law should not deal with court assistance to be available before the determination of the place of arbitration. In support of the prevailing view it was stated that neither the place of business of the claimant nor the place of business of the defendant provided an entirely satisfactory connecting factor for the purpose of determining whether court assistance should be provided. Moreover, a provision of that kind in the Model Law might interfere with other rules on court jurisdiction. It was also pointed out that even without such an extension of the applicability of the Model Law a party might be able to obtain court assistance under laws other than the Model Law. Previous discussion as to whether the applicability of articles 11, 13 and 14 should be extended to the time before the place of arbitration was determined is reported below, paras. 107-110 (article 11), para. 133 (article 13), para. 143 (article 14) and para. 148 (article 15 with reference to article 11).

81. The Commission agreed that a provision implementing that decision, which had to be included in article 1, should be formulated along the following lines: "The provisions of this Law, except articles 8, 9, 35 and 36, apply only if the place of arbitration is in the territory of this State."

* * *

CHAPTER II. ARBITRATION AGREEMENT

Article 7.

Definition and form of arbitration agreement

82. The text of article 7 as considered by the Commission was as follows:

"(1) 'Arbitration agreement' is an agreement by the parties to submit to arbitration, whether or not administered by a permanent arbitral institution, all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

"(2) The arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the

reference is such as to make that clause part of the contract."

Paragraph (1)

83. The Commission adopted the paragraph; it referred to its Drafting Group a suggestion to replace the words "all or certain disputes which have arisen or which may arise" by the words "any existing or future dispute".

Paragraph (2)

84. The Commission noted that paragraph (2) did not cover cases, encountered in practice, where one of the parties did not declare in writing his consent to arbitration. Practical examples, which were recognized by some national laws as constituting valid arbitration agreements, included the arbitration clause in a bill of lading, in certain commodity contracts and reinsurance contracts which customarily become binding on a party by oral acceptance, and in other contracts which were concluded by a written offer and an oral acceptance or by an oral offer and a written confirmation.

85. Various suggestions were made with a view to expanding the scope of paragraph (2) in order to accommodate all or at least some such cases. One suggestion was to adopt the solution found in the 1978 version of article 17 of the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, which referred to agreements "in writing or, in international trade or commerce, in a form which accords with practices in that trade or commerce of which the parties are or ought to have been aware". While there was considerable support for that suggestion, which was said to reflect the current trend towards a more liberal approach to the question of form, the Commission, after deliberation, did not accept it. It was felt that a more modest approach was appropriate in the different context of validity as to form of arbitration agreements, because the reference to trade usages was too vague to ensure uniform interpretation and entailed the possible risk that a consent to arbitration would be imposed upon a party unfamiliar with the customs prevailing in certain trades or regions.

86. Another suggestion was to add at the end of paragraph (2) the following sentence: "If a bill of lading or another document, signed by only one of the parties, gives sufficient evidence of a contract, an arbitration clause in the document, or a reference in the document to another document containing an arbitration clause, shall be considered to be an agreement in writing." While considerable support was expressed for the suggestion, the Commission, after deliberation, did not adopt the additional wording because it appeared unlikely that many States would be prepared to accept the concept of an arbitration agreement which, although contained in a document, was not signed or at least consented to in writing by both of the parties. It was also pointed out that there might be difficulties with regard to the recognition and enforcement under the 1958 New York Convention of awards based on such agreements.

87. A more limited suggestion was to include those cases where parties who had not concluded an arbitration agreement in the form required under paragraph (2) nonetheless participated in arbitral proceedings and where that fact, whether viewed as a submission or as the conclusion of an oral agreement, was recorded in the minutes of the arbitral tribunal, even though the signatures of the parties might be lacking. It was pointed out in support of the suggested extension that, although awards made pursuant to arbitration agreements evidenced in that manner would possibly be denied enforcement under the 1958 New York Convention, adoption of that extension in the Model Law might eventually lead to an interpretation of article II (2) of that Convention whereby arbitration agreements evidenced in the minutes of arbitral tribunals would be acceptable. It was noted that, if the suggestion were adopted, the condition of recognition and enforcement laid down in article 35 (2) of the Model Law, i.e. supply of original or certified copy of the arbitration agreement referred to in article 7, might have to be modified to accommodate that instance of submission (A/CN.9/264, note 91). The Commission, after deliberation, decided to extend the scope of paragraph (2) along the lines of the suggestion.

88. To implement that decision the Commission decided to add to the end of the second sentence of article 7 (2) such wording as "or in an exchange of statements of claim and defence in which one party has alleged and the other party has not denied the existence of an agreement".

* * *

Article 8.

Arbitration agreement and substantive claim before court

89. The text of article 8 as considered by the Commission was as follows:

"(1) A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

"(2) Where, in such case, arbitral proceedings have already commenced, the arbitral tribunal may continue the proceedings while the issue of its jurisdiction is pending with the court."

90. It was suggested that paragraph (2) could be read to apply only if the arbitral proceedings had commenced prior to the commencement of the judicial proceedings. The Commission agreed that the text of paragraph (2) should be amended so as to make clear that a party was not precluded from initiating arbitral proceedings by the fact that the matter had been brought before a court.

91. There was a divergence of opinion in the Commission as to whether the text should be amended so as to preclude the possibility that proceedings might go

forward concurrently in both the arbitral tribunal and the court. Under one view, if the arbitral proceedings had already commenced, the court should normally postpone its ruling on the arbitral tribunal's jurisdiction until the award was made. That would prevent the protraction of arbitral proceedings and would be in line with article VI (3) of the European Convention on International Commercial Arbitration (Geneva, 1961). Under another view, once the issue as to whether the arbitration agreement was null and void was raised before the court, priority should be accorded to the court proceedings by recognizing a power in the courts to stay the arbitral proceedings or, at least, by precluding the arbitral tribunal from rendering an award.

92. The prevailing view was to leave the current text of paragraph (2) unchanged on that point. Permitting the arbitral tribunal to continue the proceedings, including the making of an award, while the issue of its jurisdiction was before the court contributed to a prompt resolution of the arbitration. It was pointed out that expenses would be saved by awaiting the decision of the court in those cases where the court later ruled against the jurisdiction of the arbitral tribunal. However, it was for that reason not recommendable to provide for a postponement of the court's ruling on the jurisdiction of the arbitral tribunal. Furthermore, where the arbitral tribunal had serious doubts as to its jurisdiction, it would probably either proceed to a final determination of that issue in a ruling on a plea referred to in article 16 (2) or, in exercising the discretion accorded to it by article 8 (2), await the decision of the court before proceeding with the arbitration.

93. It was noted that objections to the existence of a valid arbitration agreement were referred to in articles 8 (1), 16 (2), 34 (2) (a) (i) and 36 (1) (a) (i), which apparently allowed a party wishing to obstruct or delay the arbitration to raise the same objection at four different stages. The Commission was agreed that, while it was not possible in a model law to solve potential conflicts of competence between courts of different States or between any such court and an arbitral tribunal, when considering those articles account should be taken of the need for inner consistency with a view to reducing the effects of possible dilatory tactics.

94. The Commission, after deliberation, adopted article 8, subject to modifying paragraph (2) along the following lines: "The fact that an action is brought before a court as referred to in paragraph (1) of this article does not preclude a party from initiating arbitral proceedings or, if arbitral proceedings have already commenced, the arbitral tribunal from continuing the proceedings [including the making of an award] while the issue of [its] jurisdiction is pending with the court."

* * *

Article 9.

Arbitration agreement and interim measures by court

95. The text of article 9 as considered by the Commission was as follows:

"It is not incompatible with the arbitration agreement for a party to request, before or during arbitral proceedings, from a court an interim measure of protection and for a court to grant such measure."

96. The Commission adopted the policy underlying the article and confirmed the view that the range of measures covered by the provision was a wide one and included, in particular, pre-award attachments. It was pointed out that the interim measures compatible with an arbitration agreement might, for example, also relate to the protection of trade secrets and proprietary information. It was understood that article 9 itself did not regulate which interim measures of protection were available to a party. It merely expressed the principle that a request for any court measure available under a given legal system and the granting of such measure by a court of "this State" was compatible with the fact that the parties had agreed to settle their dispute by arbitration.

97. That understanding also provided the answer to the question whether article 9 would prevent parties from excluding in the agreement resort to courts for all or certain interim measures. While the article should not be read as precluding such exclusion agreement, it should also not be read as positively giving effect to any such exclusion agreement. It was agreed that the correct understanding of article 9 might be made clearer by using the term "an arbitration agreement" instead of the term "the arbitration agreement". The Commission adopted article 9 subject to that modification.

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CHAPTER III. COMPOSITION OF ARBITRAL TRIBUNAL

Article 10.

Number of arbitrators

98. The text of article 10 as considered by the Commission was as follows:

"(1) The parties are free to determine the number of arbitrators.

"(2) Failing such determination, the number of arbitrators shall be three."

99. The Commission adopted the article.

* * *

Article 11.

Appointment of arbitrators

100. The text of article 11 as considered by the Commission was as follows:

"(1) No person shall be precluded by reason of his nationality from acting as an arbitrator, unless otherwise agreed by the parties.

"(2) The parties are free to agree on a procedure of appointing the arbitrator or arbitrators, subject to

the provisions of paragraphs (4) and (5) of this article.

"(3) Failing such agreement,

"(a) in an arbitration with three arbitrators, each party shall appoint one arbitrator, and the two arbitrators thus appointed shall appoint the third arbitrator; if a party fails to appoint the arbitrator within thirty days after having been requested to do so by the other party, or if the two arbitrators fail to agree on the third arbitrator within thirty days of their appointment, the appointment shall be made, upon request of a party, by the Court specified in article 6;

"(b) in arbitration with a sole arbitrator, if the parties are unable to agree on the arbitrator, he shall be appointed, upon request of a party, by the Court specified in article 6.

"(4) Where, under an appointment procedure agreed upon by the parties,

"(a) a party fails to act as required under such procedure; or

"(b) the parties, or two arbitrators, are unable to reach an agreement expected of them under such procedure; or

"(c) an appointing authority fails to perform any function entrusted to it under such procedure,

any party may request the Court specified in article 6 to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.

"(5) A decision on a matter entrusted by paragraph (3) or (4) of this article to the Court specified in article 6 shall be final. The Court, in appointing an arbitrator, shall have due regard to any qualifications required of the arbitrator by the agreement of the parties and to such considerations as are likely to secure the appointment of an independent and impartial arbitrator and, in the case of a sole or third arbitrator, shall take into account as well the advisability of appointing an arbitrator of a nationality other than those of the parties."

Paragraphs (1) and (2)

101. The Commission adopted those paragraphs. In that connection, it was noted that the Model Law did not contain an express provision to the effect that the arbitral tribunal had to be composed of impartial and independent members. It was understood, however, that that agreed principle was sufficiently clear from other provisions of the Model Law, in particular article 12, which set forth the grounds for challenge.

Paragraph (3)

102. The Commission adopted subparagraph (a), subject to replacing the words "within thirty days after having been requested to do so by the other party" by such words as "within thirty days of receipt of such request from the other party".

103. A suggestion was made to lay down in subparagraph (b) a time-limit, as was done in respect of the provision of subparagraph (a). The Commission was agreed that no such time-limit was required in subparagraph (b) since the persons expected to agree were the parties themselves whose inability to reach an agreement became evident by a request of one of them to the Court. Accordingly, subparagraph (b) was adopted in its current form.

Paragraph (4)

104. It was noted that the term "appointing authority" used in subparagraph (c) was not defined in the Model Law. The Commission was agreed that the term should be replaced by appropriate wording and the subparagraph be revised along the following lines: "(c) a third party, including an institution, entrusted by the parties with a function in connection with the appointment of arbitrators fails to perform this function". It was noted that such a modification made it unnecessary to include in article 2 a definition of the term "appointing authority".

Paragraph (5) and suggestions relating to functions of Court

105. The Commission adopted paragraph (5).

106. In respect of the functions of the Court envisaged under paragraphs (3), (4) and (5), an observation was made based on the concern which had earlier been expressed in the context of article 2 (e) (see above, para. 42). It was observed that the provisions of article 11 dealing with the functions of the Court, in particular if read together with the provisions of the Model Law on receipt of written communications, could be interpreted as precluding the Court from applying domestic procedural rules which, by requiring, for instance, a certain form of service or advertising, would help to reduce the risk of a party being caught in arbitral proceedings without his knowledge. The Commission decided to clarify that the provision on receipt of communications did not apply to court proceedings or measures but only to the arbitral proceedings proper, including any steps in the appointment process by a party, an arbitrator or an appointing authority.

107. As agreed in the context of the discussion on the territorial scope of application and any possible exceptions thereto (see above, paras. 76-77), the Commission considered whether court assistance in the appointment process, as provided for in article 11 (3), 11 (4) and 11 (5), should be made available even before the place of arbitration was determined, since it was the determination of the place of arbitration which triggered the general applicability of the (Model) Law in a State that had enacted it.

108. Under one view, the Model Law need not contain any such provision since it was difficult to find an acceptable connecting factor and, above all, there was no pressing need in view of the infrequency of cases where parties had agreed neither on a place of arbitration nor on an appointing authority and since even in such rare cases the existing applicable law or

laws might come to their assistance with a coherent system.

109. The prevailing view, however, was that a practical problem existed and the Model Law should provide for such assistance in order to facilitate international commercial arbitration by enabling the diligent party to secure the constitution of the arbitral tribunal. As to which should be the connecting factor, the following proposals were made: (a) place of business of defendant, (b) place of business of claimant, (c) place of business of either claimant or defendant.

110. The Commission, after deliberation, tentatively concluded that a State adopting the Model Law should make available the services of its Court referred to in article 6 for appointing an arbitrator under article 11 in those cases where the defendant had his place of business in "this State" and, possibly, in those cases where the claimant had his place of business in "this State", provided that the court in the defendant's country did not perform that function.

111. In the subsequent discussion concerning the territorial scope of application of the Model Law, the Commission decided not to extend the applicability of articles 11, 13 and 14 to the time before the place of arbitration was determined. (That discussion is reported above, paras. 79-81.)

* * *

Article 12. Grounds for challenge

112. The text of article 12 as considered by the Commission was as follows:

"(1) When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose any circumstances likely to give rise to justifiable doubts as to his impartiality or independence. An arbitrator, from the time of his appointment and throughout the arbitral proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him.

"(2) An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his impartiality or independence. A party may challenge an arbitrator appointed by him, or in whose appointment he has participated, only for reasons of which he becomes aware after the appointment has been made."

Paragraph (1)

113. The Commission adopted paragraph (1).

Paragraph (2)

114. It was noted that parties sometimes agreed that arbitrators had to have certain professional or trade qualifications and it was proposed that the Model Law should respect that aspect of party autonomy by including in paragraph (2) a reference to any additional grounds for challenge on which the parties might agree.

While some doubt was expressed as to the necessity for making such an addition to article 12, the Commission decided to adopt the proposal and requested an *ad hoc* working party, composed of the representatives of Algeria, India and the United States, to prepare a draft reflecting the decision.

115. On the basis of a proposal by the *ad hoc* working party, the Commission adopted the following amended wording of the first sentence of article 12 (2): "An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his impartiality or independence, or if he does not possess qualifications agreed to by the parties."

116. Divergent views were expressed as to the word "only" in the first sentence of paragraph (2). Under one view, the word should be deleted because there might be grounds for challenge which would not necessarily be covered by the words "impartiality or independence". By way of example, it was suggested that, without calling into question the integrity or impartiality of an arbitrator, his nationality might be a sound ground for challenge in view of the policies followed by his Government.

117. Under another view, the word "only" was useful in that it excluded other grounds for challenge not dealt with in the model law. It was pointed out that in most cases of the type falling within the example cited above the circumstances would in any event give rise to justifiable doubts as to the impartiality or independence of the arbitrator.

118. Under yet another view, the first sentence of paragraph (2) should be interpreted as limiting the grounds for challenge to the grounds provided in the model law even without the word "only". However, in order to make that point clear, some proponents of that view suggested the retention of the word "only".

119. The Commission decided to retain the word "only" in the first sentence of paragraph (2). In doing so, the Commission observed that the corresponding provision of article 10 (1) of the UNCITRAL Arbitration Rules, on which the discussed provision of the Model Law was modelled, did not contain the word "only". However, it was suggested that the UNCITRAL Arbitration Rules as contractual rules could not affect the application of any other grounds for challenge provided in mandatory rules in the applicable law, whereas it might be desirable that the Model Law prevented such other grounds for challenge from being applied in international commercial arbitration.

* * *

Article 13. Challenge procedure

120. The text of article 13 as considered by the Commission was as follows:

"(1) The parties are free to agree on a procedure for challenging an arbitrator, subject to the provisions of paragraph (3) of this article.

"(2) Failing such agreement, a party who intends to challenge an arbitrator shall, within fifteen days of the constitution of the arbitral tribunal or after becoming aware of any circumstance referred to in article 12 (2), whichever is the later, send a written statement of the reasons for the challenge to the arbitral tribunal. Unless the challenged arbitrator withdraws from his office or the other party agrees to the challenge, the arbitral tribunal shall decide on the challenge.

"(3) If a challenge under any procedure agreed upon by the parties or under the procedure of paragraph (2) of this article is not successful, the challenging party may request, within fifteen days after having received notice of the decision rejecting the challenge, the Court specified in article 6 to decide on the challenge, which decision shall be final; while such a request is pending, the arbitral tribunal, including the challenged arbitrator, may continue the arbitral proceedings."

General discussion on appropriateness of court control during arbitral proceedings

121. The Commission, before considering the provisions of article 13 in detail, embarked on a general discussion on the appropriateness of court control during arbitral proceedings. Divergent views were expressed on that matter.

122. Under one view, the court control envisaged under article 13 (3) was inappropriate and should at least be limited, in order to reduce the risk of dilatory tactics. One suggestion was to delete the provision, thus excluding court control during the arbitral proceedings, or to restrict its application considerably, for example, to those rare cases where the sole arbitrator or a majority of the arbitrators were challenged. Another suggestion was to replace in paragraph (1) the words "subject to the provisions of paragraph (3) of this article" by the words "and the decision reached pursuant to that procedure shall be final". The thrust of the suggestion was to allow the court control envisaged in paragraph (3) only if the parties had not agreed on a procedure for challenges and, in particular, not entrusted an institution or third person with deciding on the challenge. Yet another suggestion was to let the arbitral tribunal decide whether court control should be allowed immediately or only after the award was made. The suggestion was advanced as a possible solution to the problem that under article 13 a challenged arbitrator appeared to have full freedom to withdraw and that as a result of such withdrawal the party who appointed the arbitrator might be adversely affected by additional costs and delay.

123. Under another view, the weight accorded to court intervention in article 13 (3) was not sufficient in that the provision empowered the arbitral tribunal, including the challenged arbitrator, to continue the arbitral proceedings irrespective of the fact that the challenge was pending with the Court. It was stated in support of the view that such continuation would cause unnecessary waste of time and costs if the court later

sustained the challenge. At least, it should be expressed in article 13 that the arbitral tribunal was precluded from continuing the proceedings if the Court ordered a stay of the arbitral proceedings.

124. The prevailing view, however, was to retain the system adopted in article 13 since it struck an appropriate balance between the need for preventing obstruction or dilatory tactics and the desire of avoiding unnecessary waste of time and money.

125. The Commission, after deliberation, adopted the prevailing view.

Paragraph (1)

126. The Commission adopted the provision.

Paragraph (2)

127. The Commission did not adopt a suggestion to provide in paragraph (2) that the mandate of a sole arbitrator who was challenged but did not withdraw from his office terminated on account of the challenge.

128. The Commission did not adopt a suggestion to exclude the challenged arbitrator from the deliberations and the decision of the arbitral tribunal on the challenge.

129. It was noted that the challenge procedure of paragraph (2) was applicable to a sole arbitrator as well as to the challenge of one or more arbitrators of a multi-arbitrator tribunal. The refusal of a sole arbitrator to resign would constitute a rejection of the challenge, making available resort to the court under paragraph (3).

130. The Commission adopted paragraph (2), subject to certain drafting suggestions which the Commission referred to the Drafting Group.

Paragraph (3)

131. Subsequently, the Commission decided to align article 13 (3) to the modified version of article 16 (3) (see below, para. 161) and replaced the period of time of fifteen days by thirty days.

132. As regards the words "which decision shall be final", the Commission was agreed that the wording was intended to mean that no appeal was available against that decision and that that understanding might be made clear by appropriate wording. Subject to those modifications, paragraph (3) was adopted by the Commission.

133. The Commission discussed whether the Model Law should provide for Court assistance for the functions envisaged in article 13 (3) even before the place of arbitration had been determined. The Commission was agreed that the Model Law could not effectively confer international competence on the court of one State to the exclusion of the competence of another State. What the Model Law could do was to

describe those cases, by using connecting factors such as the place of business of the defendant or of the claimant, in which the particular State would render the Court assistance envisaged under article 13 (3). It was pointed out, however, that there might be less need for such assistance than in the appointment process since court control on a challenge was either provided in the applicable arbitration law or, once the Model Law applied in the case, could be exercised in the setting aside proceedings under article 34.

134. In the subsequent discussion concerning the territorial scope of application of the Model Law, the Commission decided not to extend the applicability of articles 11, 13 and 14 to the time before the place of arbitration was determined. (That discussion is reported above, paras. 79-81.)

* * *

Article 14.

Failure or impossibility to act

135. The text of article 14 as considered by the Commission was as follows:

"If an arbitrator becomes *de jure* or *de facto* unable to perform his functions or for other reasons fails to act, his mandate terminates if he withdraws from his office or if the parties agree on the termination. Otherwise, if a controversy remains concerning any of these grounds, any party may request the Court specified in article 6 to decide on the termination of the mandate, which decision shall be final."

136. It was noted that article 14, unlike articles 11 and 13, did not expressly give the parties the freedom to agree on a procedure in cases of an arbitrator's inability or failure to act. It was understood, however, that the provision was not intended to preclude parties from varying the grounds which would give rise to the termination of the mandate or from entrusting a third person or institution with deciding on such termination.

137. As regards the grounds for termination set forth in the article, various suggestions were made. One suggestion was to delete the words "*de jure* or *de facto*" since they were unnecessary and a potential source of difficulty in interpretation. The Commission did not adopt the suggestion for the sake of harmony with the corresponding provision in the UNCITRAL Arbitration Rules (article 13 (2)).

138. Another suggestion was to describe more precisely what was meant by the words "fails to act", for instance, by adding such words as "with due dispatch and with efficiency" or "with reasonable speed". It was stated in reply that the criteria of speed and efficiency, while important guidelines for the conduct of an arbitration, should not be given the appearance of constituting absolute and primary criteria for assessing the value of an arbitration. It was pointed out that the criterion of efficiency was particularly inappropriate in the context of article 14 since it could open the door to court review and assessment of the substantive work of

the arbitral tribunal. There were fewer reservations to expressing the idea of reasonable speed, which was regarded as a concretization of the time element inherent in the term "failure to act".

139. While considerable support was expressed for leaving the wording of article 14 unchanged, which corresponded with the wording found in article 13 (2) of the UNCITRAL Arbitration Rules, the Commission, after deliberation, was agreed that the expression "fails to act" should be qualified by such words as "with reasonable speed". It was understood that the addition served merely to clarify the text and should not be construed as attaching to the words "fails to act" a meaning different from the one given to the wording in the UNCITRAL Arbitration Rules.

140. A proposal was made for redrafting article 14 with a view to covering also the instances of termination included in article 15, without changing the substance of those two articles. The Commission entrusted an *ad hoc* working party, composed of the representatives of India and the United Republic of Tanzania, with the task of preparing a draft of article 14.

141. The *ad hoc* working party suggested the following modified version of article 14:

"The mandate of an arbitrator terminates, if he becomes *de jure* or *de facto* unable to perform his functions or for other reasons fails to act [with reasonable speed] or if he withdraws from his office for any reason or if the parties agree on the termination of his mandate. However, if a controversy remains concerning any of these grounds, any party may request the Court specified in article 6 to decide on the termination of the mandate, which decision shall be final."

142. Concern was expressed in the Commission that the suggested redraft of article 14 might have changed the substance of the provision in unintended ways. In particular, it was not clear when the arbitrator's mandate terminated for his failure to act. After discussion the proposal was rejected and the original text retained with the addition of words such as "with reasonable speed", as had been previously decided.

143. In the subsequent discussion concerning the territorial scope of application of the Model Law, the Commission decided not to extend the applicability of articles 11, 13 and 14 to the time before the place of arbitration was determined. (That discussion is reported above, paras. 79-81.)

* * *

Article 14 bis

144. The text of article 14 *bis* as considered by the Commission was as follows:

"The fact that, in cases under article 13 (2) or 14, an arbitrator withdraws from his office or a party agrees to the termination of the mandate of an arbitrator

does not imply acceptance of the validity of any ground referred to in article 12 (2) or 14."

145. The Commission adopted the substance of the article. It was subsequently incorporated by the Drafting Group into article 14 as new paragraph (2).

* * *

Article 15.

Appointment of substitute arbitrator

146. The text of article 15 as considered by the Commission was as follows:

"Where the mandate of an arbitrator terminates under article 13 or 14 or because of his withdrawal from office for any other reason or because of the revocation of his mandate by agreement of the parties or in any other case of termination of his mandate, a substitute arbitrator shall be appointed according to the rules that were applicable to the appointment of the arbitrator being replaced, unless the parties agree otherwise."

147. The Commission adopted the suggestion to delete in article 15 the words "unless the parties agree otherwise" since those words might create difficulties. It was understood, however, that the party autonomy recognized in article 11 for the original appointment of an arbitrator applied with equal force to the procedure of appointing the substitute arbitrator, since article 15 referred to the rules that were applicable to the appointment of the arbitrator being replaced.

148. With reference to the cases where the place of arbitration had not yet been determined, it was observed that where it was for the claimant to appoint the substitute arbitrator and the claimant failed to do so, the rule envisaged for article 11 (i.e. competence of Court of State where defendant has place of business) might not be appropriate for the appointment of the substitute arbitrator. It was suggested that a possible solution might be to provide that assistance in the appointment of the substitute arbitrator would be rendered by the Court of the State in which the party who failed to appoint his arbitrator had his place of business, and only if the Court of that State did not render such assistance could the appointment be sought from the Court in the State where the other party had his place of business. However, according to a subsequent decision, reported above in para. 111, the applicability of article 11 was not extended to the time before the place of arbitration was determined.

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CHAPTER IV. JURISDICTION OF ARBITRAL TRIBUNAL

Article 16.

Competence to rule on own jurisdiction

149. The text of article 16 as considered by the Commission was as follows:

"(1) The arbitral tribunal has the power to rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause.

"(2) A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence. A party is not precluded from raising such a plea by the fact that he has appointed, or participated in the appointment of, an arbitrator. A plea that the arbitral tribunal is exceeding the scope of its authority shall be raised promptly after the arbitral tribunal has indicated its intention to decide on the matter alleged to be beyond the scope of its authority. The arbitral tribunal may, in either case, admit a later plea if it considers the delay justified.

"(3) The arbitral tribunal may rule on a plea referred to in paragraph (2) of this article either as a preliminary question or in an award on the merits. In either case, a ruling by the arbitral tribunal that it has jurisdiction may be contested by any party only in an action for setting aside the arbitral award."

Paragraph (1)

150. The Commission was agreed that the words "including any objections with respect to the existence or validity of the arbitration agreement" were not intended to limit the *Kompetenz-Kompetenz* of the arbitral tribunal to those cases where a party had raised an objection. Consequently, the arbitral tribunal could decide on its own motion if there were doubts or questions as to its jurisdiction, including the issue of arbitrability.

151. As regards the power given to the arbitral tribunal in paragraph (1), concern was expressed that the provision would not be acceptable to certain States which did not grant such power to arbitrators or to those parties who did not want arbitrators to rule on their own jurisdiction. It was stated in reply that the principle embedded in the paragraph was an important one for the functioning of international commercial arbitration; nonetheless, it was ultimately for each State, when adopting the Model Law, to decide whether it wished to accept the principle and, if so, possibly to express in the text that parties could exclude or limit that power.

152. It was noted that the apparent vigor of the English words "has the power to rule" was, for example, not reflected in the French wording "*peut statuer*". The Commission, after deliberation, decided to use in all languages the less vigorous wording "may rule" without thereby intending to deviate in substance from the corresponding wording used in article 21 (1) of the UNCITRAL Arbitration Rules.

153. The Commission adopted paragraph (1) as so amended.

Paragraph (2)

154. It was stated that the third sentence of paragraph (2) was too imprecise in that it referred to the indication of the arbitral tribunal's intention to decide on a matter alleged to be beyond the scope of its authority. It was pointed out that such intention would normally be clear only when there was an award covering that matter. It was, therefore, suggested that the sentence should be replaced by a provision modelled on article V (1) of the 1961 Geneva Convention to the effect that the plea must be raised as soon as the question on which the arbitral tribunal was alleged to have no jurisdiction was raised during the arbitral proceedings.

155. It was recognized that the proposed text was more precise but also more rigid than the current text. For instance, it would cover not only those instances where there was an indication of the intention of the arbitral tribunal itself, e.g. where it requested or examined evidence relating to a matter outside its scope of authority, but also the case where one party in its written or oral statements raised such a matter. In such a case, under the proposed text the other party would have to raise his objection promptly. The concern was expressed that parties who were not sophisticated in international commercial arbitration might not realize that a matter exceeding the arbitral tribunal's jurisdiction had been raised and that they were compelled to object promptly. Moreover, it was suggested that in some cases the governing law, and therefore limitations on arbitrability of certain disputes, might not be determined until the time of award, making an earlier plea impossible. As a result, failure to raise the plea at an earlier time should not necessarily preclude its use in setting aside proceedings or in recognition and enforcement proceedings.

156. The Commission, after deliberation, adopted paragraph (2), subject to modification of the third sentence along the following lines: "A plea that the arbitral tribunal has exceeded the scope of its authority shall be raised as soon as the question on which the arbitral tribunal is alleged to have no jurisdiction is raised during the arbitral proceedings."

Paragraph (3)

157. The Commission adopted the principle underlying paragraph (3), namely that the competence of the arbitral tribunal to rule on its own jurisdiction was subject to court control. However, there was a divergence of views as to when and under what circumstances such resort to a court should be available.

158. Under one view, the solution adopted in paragraph (3) was appropriate in that it permitted such court control only in setting aside proceedings and, as should be clarified in the text, in the context of recognition and enforcement of awards. That solution was preferred to instant court control since it would prevent abuse by a party for purposes of delay or obstruction of the proceedings.

159. Under another view, paragraph (3) should be modified so as to empower the arbitral tribunal to grant leave for an appeal to the court or in some other way, for instance by making its ruling in the form of an award, permit instant court control. It was stated in support that such flexibility was desirable since it would enable the arbitral tribunal to assess in each particular case whether the risk of dilatory tactics was greater than the opposite danger of waste of money and time. As regards that possible danger, the suggestion was made to reduce its effect by providing some or all of the safeguards envisaged in the context of court control over a challenge of an arbitrator in article 13 (3), i.e. short time-period, finality of decision, discretion to continue the arbitral proceedings and to render an award.

160. Under yet another view, it was necessary to allow the parties instant resort to the court in order to obtain certainty in the important question of the arbitral tribunal's jurisdiction. Various suggestions were made for achieving that result. One suggestion was to adopt the solution found in article 13 (3) and thus to allow immediate court control in each case where the arbitral tribunal ruled on the issue of its jurisdiction as a preliminary question. Another suggestion was to require the arbitral tribunal, if so requested by a party, to rule on its jurisdiction as a preliminary question, which ruling would be subject to immediate court control. Yet another suggestion was to reintroduce in the text previous draft article 17.⁸ It was pointed out that, if draft article 17 were reintroduced in the model law, it might not be necessary to adopt for the concurrent court control in article 16 (3) the strict solution which would exclude any discretion on the part of the arbitral tribunal.

161. The Commission, after deliberation, decided not to reintroduce previous draft article 17 but to provide for instant court control in article 16 (3) along the lines of the solution adopted in article 13 (3). The Commission adopted article 16 (3) in the following modified form, subject to redrafting by the Drafting Group:

"(3) The arbitral tribunal may rule on a plea referred to in paragraph (2) of this article either as a preliminary question or in an award on the merits. If the arbitral tribunal determines in a preliminary ruling that it has jurisdiction, any party may request, within thirty days after having received notice of that ruling, the Court specified in article 6 to decide the matter, which decision shall not be subject to appeal; while such a request is pending, the arbitral tribunal may continue the arbitral proceedings."

⁸The text of draft article 17, which was deleted by the Working Group at its last session (A/CN.9/246, paras. 52-56), was as follows:

"Article 17. *Concurrent court control*

"(1) [Notwithstanding the provisions of article 16,] a party may [at any time] request the Court specified in article 6 to decide whether a valid arbitration agreement exists and [if arbitral proceedings have commenced,] whether the arbitral tribunal has jurisdiction [with regard to the dispute referred to it].

"(2) While such issue is pending with the Court, the arbitral tribunal may continue the proceedings [unless the Court orders a stay of the arbitral proceedings]."

162. The Commission decided to align article 13 (3) to that modified version of article 16 (3) and thus to replace in article 13 (3) the time-period of fifteen days by a time-period of thirty days and the expression "final" by such words as "not subject to appeal".

163. It was noted that the second sentence of article 16 (3) did not cover the case where the arbitral tribunal ruled that it had no jurisdiction. Consequently, in such a case, article 16 (3), read together with article 5, did not preclude resort to a court for obtaining a decision on whether a valid arbitration agreement existed. It was recognized that a ruling by the arbitral tribunal that it lacked jurisdiction was final as regards its proceedings since it was inappropriate to compel arbitrators who had made such a ruling to continue the proceedings.

* * *

Article 18.

Power of arbitral tribunal to order interim measures

164. The text of article 18 as considered by the Commission was as follows:

"Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute. The arbitral tribunal may require any party to provide security for the costs of such measure."

165. A suggestion was made that the provision should not be retained since its scope was not clearly defined and because its was of limited practical relevance in view of the availability of enforceable interim measures by courts. Furthermore, the power granted to the arbitral tribunal could operate to the detriment of a party if it later turned out that the interim measure was not justified. Therefore, if the provision were to be retained, that risk should be reduced by enlarging the extent of the security referred to in the second sentence to cover not only the costs of such interim measure but also any possible or foreseeable damage to a party.

166. The Commission, after deliberation, decided to retain the article since it was useful in confirming that the arbitral tribunal's mandate included the faculty of ordering such measures, unless the parties had agreed otherwise. As regards the suggestion to enlarge the extent of the security which the arbitral tribunal might require from a party or the parties, the Commission was agreed that, on the one hand, any implied limitation on security for the costs of such measure should not be maintained but that, on the other hand, a reference to the damages of a party was not appropriate since the Model Law should not deal with questions relating to the basis or extent of possible liability for damages. The Commission, therefore, decided to use more general wording and to say that the arbitral tribunal might require any party to provide "appropriate security". It was pointed out that the modification should not lead to an interpretation of the words "security for the costs of such measures", as used in

article 26 (2) of the UNCITRAL Arbitration Rules, as excluding the possibility of including in the amount of such security any foreseeable damage of a party.

167. As regards the range of interim measures covered by the provision, it was observed that one of the possible measures was, under appropriate circumstances, an order relating to the protection of trade secrets and proprietary information.

168. It was noted that the range of interim measures covered by article 18 was considerably narrower than that envisaged under article 9 and that article 18 did not regulate the question of enforceability of such measures taken by the arbitral tribunal. It was observed that, nonetheless, there remained an area of overlapping and possible conflict between measures by the arbitral tribunal and by a court. Therefore, a suggestion was made that the Model Law should provide a solution for such conflicts, for instance, by according priority to the decision of the courts.

169. The Commission, after deliberation, was agreed that the Model Law should not embody a solution for such conflicts. It was stated that any such solution was a matter for each State to decide in accordance with its principles and laws pertaining to the competence of its courts and the legal effects of court decisions. It was noted, in that context, that article 9 itself neither created nor aggravated the potential of such conflict since it did not regulate whether and to what extent court measures were available under a given legal system but only expressed the principle that any request for, and the granting of, such interim measure, if available in a legal system, was not incompatible with the fact that the parties had agreed to settle their dispute outside the courts by arbitration.

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CHAPTER V. CONDUCT OF ARBITRAL PROCEEDINGS

Article 19.

Determination of rules of procedure

170. The text of article 19 as considered by the Commission was as follows:

"(1) Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings.

"(2) Failing such agreement, the arbitral tribunal may, subject to the provisions of this Law, conduct the arbitration in such manner as it considers appropriate. The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance, materiality and weight of any evidence.

"(3) In either case, the parties shall be treated with equality and each party shall be given a full opportunity of presenting his case."

Paragraph (1)

171. Two suggestions of divergent significance were made with respect to paragraph (1). One suggestion was to make clear in the model law that the freedom of the parties to agree on the procedure should be a continuing one throughout the arbitral proceedings. The other suggestion was to permit the parties to determine rules of procedure after the arbitrators had accepted their duties to the extent the arbitrators agreed.

172. Neither suggestion was adopted. Although the provision as it now stood implied that the parties had a continuing right to change the procedure, the arbitrators could not in fact be forced to accept changes in the procedure because they could resign if they did not wish to carry out new procedures agreed to by the parties. It was noted that the time-frame allowed for changing the procedures to be followed could be settled between the parties and the arbitrators.

Paragraph (2)

173. An observation was made that, since in some legal systems a question of admissibility, relevance, materiality and weight of evidence would be considered to be a matter of substantive law, the question arose as to the relationship between the second sentence of paragraph (2) and article 28.

174. It was understood that the objective of paragraph (2) was to recognize a discretion of the arbitral tribunal which would not be affected by the choice of law applicable to the substance of the dispute.

175. The Commission adopted paragraph (2).

Paragraph (3)

176. The Commission was agreed that the provision contained in paragraph (3) constituted a fundamental principle which was applicable to the entire arbitral proceedings and that, therefore, the provision should form a separate article 18 *bis* to be placed at the beginning of chapter V of the Model Law. That decision was tentatively made in the context of the discussion of article 22 (see below, paras. 189-194) and confirmed in a later discussion of article 19 (3).

* * *

*Article 20.**Place of arbitration*

177. The text of article 20 as considered by the Commission was as follows:

"(1) The parties are free to agree on the place of arbitration. Failing such agreement, the place of arbitration shall be determined by the arbitral tribunal.

"(2) Notwithstanding the provisions of paragraph (1) of this article, the arbitral tribunal may, unless otherwise agreed by the parties, meet at any place it considers appropriate for consultation among its members, for hearing witnesses, experts or the parties,

or for inspection of goods, other property, or documents."

178. A proposal was made to add to the end of the second sentence of paragraph (1) the words: "having regard to the circumstances of the arbitration, including the convenience of the parties". It was stated in support of the proposal that the venue of arbitration was of considerable practical importance and that inclusion of the convenience of the parties as a guiding factor could meet the concern felt by some persons, in particular in developing countries, that an inconvenient location might be imposed on them. It was noted that the concern was also felt in other countries.

179. Divergent views were expressed as to the appropriateness of the proposed wording. Under one view the additional words were unnecessary since they expressed a principle which was already implicit in article 19 (3). Particular opposition was expressed to the words "including the convenience of the parties". It was said to be unbalanced to mention only some circumstances to be taken into consideration by the arbitrators in determining the place of arbitration, since other factors such as the suitability of the applicable procedural law, the availability of procedures for recognition or enforcement of awards under the 1958 New York Convention or other multilateral or bilateral treaties or, eventually, whether a State had adopted the Model Law might be of at least equal importance. It was also noted that article 16 (1) of the UNCITRAL Arbitration Rules provided that in determining the place of arbitration the arbitrators were to have regard to the circumstances of the arbitration but that the convenience of the parties was not mentioned. It was suggested that a discrepancy between the two texts on that point was undesirable.

180. However, the prevailing view was that the Model Law should refer to the convenience of the parties as a circumstance of great importance in the determination of the place of arbitration in international commercial arbitration. It was understood at the same time that the convenience of the parties should be interpreted as including the above-mentioned considerations regarding the applicable procedural law and the recognition and enforcement of awards.

181. The Commission adopted article 20 as so amended.

* * *

*Article 21.**Commencement of arbitral proceedings*

182. The text of article 21 as considered by the Commission was as follows:

"Unless otherwise agreed by the parties, the arbitral proceedings in respect of a particular dispute commence on the date on which a request for that dispute to be referred to arbitration is received by the respondent."

183. A proposal was made that had two parts. The first part would give a request which referred a dispute to arbitration the same legal effect as if the request had been filed with a court. The second part of the proposal would permit a claimant who commenced an action in court within a short period of time following receipt of a ruling by an arbitral tribunal rejecting jurisdiction or following receipt of a judgment setting aside an award to be free of the plea that the period of limitation had run.

184. It was suggested that the problem was important. The proposal would enhance the effectiveness of international commercial arbitration by providing a claimant in arbitration a degree of protection against the running of the period of limitation equivalent to that enjoyed by the plaintiff in a court proceeding. A number of legal systems had rules such as the one proposed while many legal systems did not, and uniformity in that respect would be useful. It was noted that a similar result was achieved by articles 14 (1) and 17 of the 1974 Convention on the Limitation Period in the International Sale of Goods, which had been elaborated by the Commission. Those provisions read as follows:

Article 14

"(1) Where the parties have agreed to submit to arbitration, the limitation period shall cease to run when either party commences arbitral proceedings in the manner provided for in the arbitration agreement or by the law applicable to such proceedings."

Article 17

"(1) Where a claim has been asserted in legal proceedings within the limitation period in accordance with articles 13, 14, 15 or 16, but such legal proceedings have ended without a decision binding on the merits of the claim, the limitation period shall be deemed to have continued to run.

"(2) If, at the time such legal proceedings ended, the limitation period has expired or has less than one year to run, the creditor shall be entitled to a period of one year from the date on which the legal proceedings ended."

185. However, the prevailing view was not to include in the Model Law a provision on the proposed issues, although it was recognized that the problem existed and that a unified solution of the problem would be welcome. Such a provision touched upon issues regarded by many legal systems as matters of substantive law and might therefore be considered to be outside the scope of the Model Law. In some countries periods of limitation were to be found in a number of different statutes and, in some cases, were subject to different domestic legal rules. It would be anomalous and a source of confusion to have a special rule for the effects on the limitation period arising out of the commencement of an international commercial arbitration. As a result of those factors the elaboration of a rule of the proposed type, in order to be acceptable in different legal systems, required a close study of the issues involved, which, for lack of time, could not be undertaken during the current session.

186. It was especially for that last reason that the Commission, after deliberation, decided not to adopt the proposal. It was agreed, however, that the attention of States should be drawn to that problem of considerable practical importance with a view to inviting consideration of enacting provisions which, in harmony with the principles and norms of the given legal system, would place arbitral proceedings on equal footing with court proceedings in that respect.

187. The Commission did not adopt a proposal to include in article 21 a rule providing that in the case of arbitration administered by an arbitral institution the arbitral proceedings commenced on the date on which a request for arbitration was received by the arbitral institution. While some support was expressed for the proposal, the prevailing view was that, as a result of the wide variety of rules used by different arbitral institutions for the commencement of arbitral proceedings, including the fact that in some rules the request for arbitration need not be received by the institution, it would be difficult to formulate one approach to the issue. It was noted that, since article 21 was subject to contrary agreement by the parties, the purpose of the above proposal could be achieved by a provision in the arbitration rules, as is often found in standard rules of arbitral institutions, to the effect that the arbitral proceedings commenced on the date on which a request for arbitration was received by the arbitral institution.

* * *

*Article 22.
Language*

188. The text of article 22 as considered by the Commission was as follows:

"(1) The parties are free to agree on the language or languages to be used in the arbitral proceedings. Failing such agreement, the arbitral tribunal shall determine the language or languages to be used in the proceedings. This agreement or determination, unless otherwise specified therein, shall apply to any written statement by a party, any hearing and any award, decision or other communication by the arbitral tribunal.

"(2) The arbitral tribunal may order that any documentary evidence shall be accompanied by a translation into the language or languages agreed upon by the parties or determined by the arbitral tribunal."

189. The Commission noted that the determination of the language or languages of the arbitral proceedings involved both a matter of principle and a matter of practicality. The principle, set forth in article 19 (3), was that the parties must be treated with equality and each party must be given a full opportunity of presenting his case. At the same time, it was recognized that extensive interpretation of oral proceedings and translation of written documents would increase the costs of the arbitration and, in the case of extensive translations, prolong the proceedings.

190. A proposal that article 22 should specifically provide that, failing agreement of the parties, the language or languages to be used in the proceedings should be determined by the arbitral tribunal in accordance with article 19 (3) was not accepted as being unnecessary. For the same reason the Commission did not accept a proposal to state expressly that a party had a right to express himself in his own language provided he arranged for interpretation into the language of the proceedings.

191. Yet another proposal was that the arbitral proceedings should be conducted in the languages of the parties unless the parties agreed on one language or the arbitral tribunal, on the basis of an express mandate conferred to it by the parties, determined the language of the proceedings. The proponents of that proposal suggested that, if this was not accepted, the Model Law should provide that any party whose language was not chosen as the language of the proceedings had the right of presenting his case in his language, and the costs of translation and interpretation should form part of the costs of the proceedings. However, the proposal was not accepted since it was considered to be too rigid and not capable of providing a suitable solution for the wide variety of situations which arose in practice. It was thought to be appropriate to leave the determination of the language or languages of the proceedings to the arbitral tribunal, which was in all circumstances bound by article 19 (3).

192. Noting that the word "translation" in paragraph (2) was not defined, a proposal was made that a translation should be duly certified. The proposal was not accepted on the ground that a general requirement of certification of translations would unnecessarily add to the costs of proceedings.

193. It was noted that where proceedings were to be conducted in more than one language, it might be reasonable and not prejudicial to the interests of the parties if a document was translated into only one of the languages of the proceedings. Consequently, it was proposed that article 22 should provide expressly that it would not be *per se* contrary to the Model Law if in a multi-language arbitration the arbitral tribunal decided that a particular document did not have to be translated into all the languages of the proceedings. While the Commission was of the view that such cost-saving practices were not prohibited by article 22, it referred to the Drafting Group the question whether the text expressed that view with sufficient clarity.

194. The Commission adopted article 22, subject to the review by the Drafting Group as indicated in the previous paragraph. In order to emphasize the fundamental nature of the principles embodied in article 19 (3) and to clarify that they governed all aspects of the arbitral proceedings, it was agreed that the paragraph should be presented in a separate article.

* * *

Article 23.

Statements of claim and defence

195. The text of article 23 as considered by the Commission was as follows:

"(1) Within the period of time agreed by the parties or determined by the arbitral tribunal, the claimant shall state the facts supporting his claim, the points at issue and the relief or remedy sought, and the respondent shall state his defence in respect of these particulars. The parties may annex to their statements all documents they consider to be relevant or may add a reference to the documents or other evidence they will submit.

"(2) Unless otherwise agreed by the parties, either party may amend or supplement his claim or defence during the course of the arbitral proceedings, unless the arbitral tribunal considers it inappropriate to allow such amendment having regard to the delay in making it or prejudice to the other party or any other circumstances."

Paragraph (1)

196. The Commission was agreed that paragraph (1) expressed a basic principle of arbitral procedure from which the parties should not be able to derogate but that the specific rules of procedure in respect of the statements of claim and defence should be subject to the agreement of the parties. It was pointed out that the procedure provided in paragraph (1) was not entirely consistent with the procedure in some institutional arbitration rules. The Commission decided to express the distinction between the mandatory nature of the principle expressed in paragraph (1) and the non-mandatory nature of the procedural rules by adding to the end of the first sentence words along the lines of "unless the parties have otherwise agreed on the contents and form of such statements".

197. It was also noted that the verb "annex" contained in the second sentence of paragraph (1) might be interpreted to require a statement of claim or defence always to be in writing. The Commission, being in agreement that that was not the intended interpretation, referred the matter to the Drafting Group.

Paragraph (2)

198. Different views were expressed as to the power of the arbitral tribunal to allow an amendment of a statement of claim or defence. Under one view, the parties should not be prevented from amending their statements of claim or defence since any limitation in that respect would be contrary to their right to present their case. Under that view a full stop should be placed after the words "arbitral proceedings". Recognizing that a late amendment might cause delay in the proceedings, it was suggested that the appropriate way of dealing with the problem was by apportioning the costs of the proceedings or by deciding on the issues presented in good time in a partial award and postponing the settlement of the remaining issues.

199. However, under the prevailing view the arbitral tribunal should have a power not to allow amendments to the statement of claim or defence under certain circumstances. Several views were expressed as to how the scope of that power should be delimited. Under one view, which received considerable support, the entire text of paragraph (2) should be retained because it provided appropriate guarantees against delay in arbitral proceedings while allowing sufficient flexibility in justified cases. Under another view, the words "any other circumstances" were too vague and should either be replaced by the words "any other relevant circumstances" or deleted. Under yet another view, the desired precision could be achieved only by deletion of the words "or prejudice to the other party" as well since it was not clear what kind of prejudice was meant.

200. The Commission adopted the latter view and decided to delete the words "or prejudice to the other party or any other circumstances".

Counter-claim

201. A suggestion was made to add a provision, either in article 23 or in another appropriate place, that any provision of the Model Law referring to the claim would apply, *mutatis mutandis*, to a counter-claim. It was agreed that the Commission would consider the matter after it had completed its consideration of the entire draft Model Law. The subsequent decision in respect of counter-claims is reflected below in para. 327.

* * *

Article 24.

Hearings and written proceedings

202. The text of article 24 as considered by the Commission was as follows:

"(1) Subject to any contrary agreement by the parties, the arbitral tribunal shall decide whether to hold oral hearings or whether the proceedings shall be conducted on the basis of documents and other materials.

"(2) Notwithstanding the provisions of paragraph (1) of this article, if a party so requests, the arbitral tribunal may, at any appropriate stage of the proceedings, hold hearings for the presentation of evidence or for oral argument.

"(3) The parties shall be given sufficient advance notice of any hearing and of any meeting of the arbitral tribunal for inspection purposes.

"(4) All statements, documents or other information supplied to the arbitral tribunal by one party shall be communicated to the other party. Also any expert report or other document, on which the arbitral tribunal may rely in making its decision, shall be communicated to the parties."

Paragraphs (1) and (2)

203. The Commission noted that article 24 dealt with the issue of the mode of arbitral proceedings as a

matter of principle and did not deal with the procedural aspects of deciding that issue. For example, the article did not deal with the question of the point of time when the arbitral tribunal would have to decide on the mode of the arbitral proceedings. That meant that the arbitral tribunal was free to decide that question at the outset of the proceedings, or it could postpone the determination of the mode of the proceedings and make such determinations in the light of the development of the case. Before so deciding the arbitral tribunal would normally request the parties to express their view or possible agreement on the question. The article also did not deal with, and therefore did not limit, the power of the arbitral tribunal to decide on the length of oral hearings, on the stage at which oral hearings could be held, or on the question whether the arbitral proceedings would be conducted partly on the basis of oral hearings and partly on the basis of documents. It was noted that such procedural decisions were governed by article 19, including its paragraph (3).

204. The Commission was agreed that an agreement by the parties that oral hearings were to be held was binding on the arbitral tribunal.

205. As to the question whether an agreement by the parties that there would be no oral hearings was also binding, different views were expressed. Under one view, the right to oral hearings was of such fundamental importance that the parties were not bound by their agreement and a party could always request oral hearings. Under another view, the agreement of the parties that no oral hearings would be held was binding on the parties but not on the arbitral tribunal so that the arbitral tribunal, if requested by a party, had the discretion to order oral hearings. However, the prevailing view was that an agreed exclusion of oral hearings was binding on the parties and the arbitral tribunal. Nevertheless, it was noted that article 19 (3), requiring that each party should be given a full opportunity to present his case, might in exceptional circumstances provide a compelling reason for holding an oral hearing. It was understood that parties who had earlier agreed that no hearings should be held were not precluded from later modifying their agreement, and thus to allow a party to request oral hearings.

206. The Commission was agreed that where there was no agreement on the mode of the proceedings a party had a right to oral hearings if he so requested. In that connection it was noted that the French version of paragraph (2) reflected that view while according to other versions of that paragraph the arbitral tribunal retained the discretion whether to hold oral hearings even if requested by a party.

207. The Commission was also agreed that where there was no agreement on the mode of the proceedings, and no party had requested an oral hearing, the arbitral tribunal was free to decide whether to hold oral hearings or whether the proceedings would be conducted on the basis of documents and other materials.

208. The Commission referred the implementation of its decisions to the Drafting Group.

209. During consideration of the second sentence of article 24 (1), as presented by the Drafting Group, which read as follows: "However, unless the parties have agreed that no hearings shall be held, the arbitral tribunal shall, if so requested by a party at an appropriate stage of the proceedings, hold such hearings", the question was raised whether "at an appropriate stage" should refer to the request or to the proceedings. After discussion the Commission decided to re-word the sentence as follows: "However, unless the parties have agreed that no hearings shall be held, the arbitral tribunal shall hold such hearings at an appropriate stage of the proceedings, if so requested by a party."

Paragraph (3)

210. The Commission was agreed that the words "for inspection purposes" were meant to include the inspection of goods, other property, or documents as referred to in article 20 (2), and that that should be made clear in the text. Subject to that modification, paragraph (3) was adopted.

Paragraph (4)

211. The Commission agreed with the first sentence of paragraph (4) that all documents supplied to the arbitral tribunal by one party, regardless of their nature, had to be communicated to the other party. However, the Commission was agreed that in the second sentence of paragraph (4) it should be made clear that such documents as research material prepared or collected by the arbitral tribunal did not have to be communicated to the parties. The Drafting Group was invited to consider whether that result should be achieved by deletion of the words "or other document".

* * *

Article 25.

Default of a party

212. The text of article 25 as considered by the Commission was as follows:

"Unless otherwise agreed by the parties, if, without showing sufficient cause,

"(a) the claimant fails to communicate his statement of claim in accordance with article 23 (1), the arbitral proceedings shall be terminated;

"(b) the respondent fails to communicate his statement of defence in accordance with article 23 (1), the arbitral tribunal shall continue the proceedings without treating such failure as an admission of the claimant's allegations;

"(c) any party fails to appear at a hearing or to produce documentary evidence, the arbitral tribunal may continue the proceedings and make the award on the evidence before it."

213. The Commission agreed that the text of article 25 should make it clear that in order for the party in default to escape the consequences of article 25, he should show to the arbitral tribunal sufficient cause for

his failure to act as required. It was thought that the text was already sufficiently clear that the sufficient cause for the delay had to exist before the time the action was due. However, as to the point of time when sufficient cause was to be shown to the arbitral tribunal, it was thought that, although it was clear from the article that the question whether there was sufficient cause for the failure had to be settled before the arbitral tribunal decided on a consequence of default, a definition of a point of time in the text would be difficult and would unnecessarily interfere with the discretion of the arbitral tribunal to assess the cause for delay and to extend the period of time when the party must communicate a statement or produce evidence.

214. It was suggested that subparagraph (b) should not be interpreted as meaning that the arbitral tribunal would have no discretion as to how to assess the cause of the failure to communicate the statement of defence as required and that it would be precluded from drawing inferences from such failure. The Commission was agreed that the correct interpretation should be made clear in subparagraph (b) by using an expression such as "without treating such failure in itself . . .".

215. A proposal was made to restrict the discretion of the arbitral tribunal in subparagraph (c) by obliging it to continue the arbitral proceedings if the party not in default so requested. The Commission did not adopt the proposal on the ground that an obligation to continue the arbitral proceedings might be seen as a restriction of the discretion of the arbitral tribunal in assessing whether there was sufficient cause for a party's failure to appear at a hearing or to produce documentary evidence.

216. The Commission adopted article 25, subject to the amendments to the opening words of the article and to subparagraph (b), which were referred to the Drafting Group.

* * *

Article 26.

Expert appointed by arbitral tribunal

217. The text of article 26 as considered by the Commission was as follows:

"(1) Unless otherwise agreed by the parties, the arbitral tribunal

"(a) may appoint one or more experts to report to it on specific issues to be determined by the arbitral tribunal;

"(b) may require a party to give the expert any relevant information or to produce, or to provide access to, any relevant documents, goods or other property for his inspection.

"(2) Unless otherwise agreed by the parties, if a party so requests or if the arbitral tribunal considers it necessary, the expert shall, after delivery of his written or oral report, participate in a hearing where the parties have the opportunity to interrogate him and to present expert witnesses in order to testify on the points at issue."

218. A proposal was made to amend the opening words of paragraph (1) to read: "Unless otherwise agreed by the parties before an arbitrator is appointed, ...". Under one view the proposal was desirable since it might be of great importance to a person when asked to serve as an arbitrator whether the arbitral tribunal would be empowered to order an expertise. The rules under which the arbitrators would be expected to function should be clear to them from the beginning.

219. However, under the prevailing view the parties should always have the right to decide that the arbitral tribunal was not free to appoint experts. Even though the parties could be expected to have confidence in the arbitrators they had named to settle their dispute, they might not have confidence in the expert or experts that the arbitral tribunal proposed to appoint. Moreover, the appointment of experts might increase the costs of the arbitration beyond the amount the parties were willing to spend. If the joint refusal of the parties to permit the arbitral tribunal to appoint an expert was of such importance to the arbitrators, they were free to resign. If such resignation was a likely result, it could be assumed that the parties would carefully consider their decision and the risk that the money already spent on the arbitration would be wasted. Since article 26 represented a compromise between the common law system of adjudication in which appointment of experts by the court or tribunal was not usual and the civil law system in which such appointments were common, the balance of the compromise should not be disturbed.

220. A proposal to delete the words "Unless otherwise agreed by the parties," was not retained.

221. The Commission adopted article 26.

* * *

Article 27.

Court assistance in taking evidence

222. The text of article 27 as considered by the Commission was as follows:

"(1) In arbitral proceedings held in this State or under this Law, the arbitral tribunal or a party with the approval of the arbitral tribunal may request from a competent court of this State assistance in taking evidence. The request shall specify:

"(a) the names and addresses of the parties and the arbitrators;

"(b) the general nature of the claim and the relief sought;

"(c) the evidence to be obtained, in particular,

"(i) the name and address of any person to be heard as witness or expert witness and a statement of the subject-matter of the testimony required;

"(ii) the description of any document to be produced or property to be inspected.

"(2) The court may, within its competence and according to its rules on taking evidence, execute the

request either by taking the evidence itself or by ordering that the evidence be provided directly to the arbitral tribunal."

Paragraph (1)

223. The commission was in agreement that, in conformity with a general decision previously taken, the scope of application of the article should be limited territorially. Subject to drafting changes called for as a result of the decision yet to be taken on the specific text in regard to territorial scope of application of the Model Law as a whole, the Commission decided to delete the words "or under this Law".

224. Subsequently, in light of the decision to adopt the text of article 1 (1 *bis*) (see above, para. 81), the Commission also decided to delete the words "held in this State" as being unnecessary since, except as provided in that article, the entire Model Law applied only to arbitral proceedings held in "this State".

225. The Commission was also in agreement that the question of international assistance in the taking of evidence in arbitral proceedings should not be governed by the Model Law. It noted that the Hague Conference on Private International Law was studying the possibility of preparing a protocol to the 1970 Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters to extend its application to arbitral proceedings and that the Hague Conference would be interested in the views of arbitration experts whether such a protocol would be desirable.

226. The Commission did not adopt a proposal to limit paragraph (1) to an indication that a competent court might be requested to assist in taking evidence without referring to whether it was the arbitral tribunal or the parties who might make the request to the court. It was noted that the current provision was a compromise between those legal systems in which only the arbitral tribunal might request the court for assistance and those legal systems in which a party might request the court for assistance. In the current text either the arbitral tribunal or a party might request such assistance, but in the latter case only if the arbitral tribunal approved.

227. It was noted that paragraph (1) indicated only the court to which the request should be addressed, but that the routing by which that request should reach the court would be determined by local procedures. An observation was made that States adopting the Model Law might wish to entrust the functions of court assistance in taking evidence to the court or other authority specified in article 6 and that that should be reflected by appropriate drafting.

228. The Commission decided to delete the second sentence of paragraph (1), including subparagraphs (a), (b) and (c), on the grounds that they entered into excessive detail that did not need to be expressed in the Model Law.

229. The Commission did not adopt a proposal to add a new provision to the effect that, where evidence was possessed by a party and the party refused to comply with an order to produce it, the arbitral tribunal should be expressly empowered to interpret the refusal to that party's disadvantage. It was suggested, and not contradicted in the Commission, that such a provision was unnecessary since the arbitral tribunal already had that power, particularly under article 25 (c).

Paragraph (2)

230. The Commission decided to place a full stop after the words "execute the request" and to delete the remainder of the sentence. It was felt that there was no need to indicate the manner in which the court should execute the request. Moreover, in some countries it would be difficult to imagine the court ordering that the evidence be provided directly to the arbitral tribunal.

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CHAPTER VI. MAKING OF AWARD AND TERMINATION OF PROCEEDINGS

Article 28.

Rules applicable to substance of dispute

231. The text of article 28 as considered by the Commission was as follows:

"(1) The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of laws rules.

"(2) Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

"(3) The arbitral tribunal shall decide *ex aequo et bono* or as *amiable compositeur* only if the parties have expressly authorized it to do so."

Paragraphs (1) and (2)

232. In the discussion on paragraph (1), the Commission was divided on the question whether the Model Law should recognize the right of the parties to subject their legal relationship to "rules of law". Under one view, the Model Law should recognize that right of the parties since it was not appropriate in international commercial arbitration to limit the freedom of the parties to choosing the law of a given State. While recognizing the novel and imprecise character of the term "rules of law", which to date had been adopted only in one international convention and two national laws, it was stated in support that it would provide the necessary flexibility to allow parties in international commercial transactions to subject their relationship to those rules of law which they regarded as the most suitable ones for their specific case. It would enable them, for example, to choose provisions of different laws to govern different parts of their relationship, or to

select the law of a given State except for certain provisions, or to choose the rules embodied in a convention or similar legal text elaborated on the international level, even if not yet in force or not in force in any State connected with the parties or their transaction. It was pointed out that, as regards any interest of the State where the arbitration took place, to recognize such freedom was not essentially different from allowing the designation of the law of a State which was in no way connected with the parties or their relationship. Furthermore, since article 28 (3) permitted the parties to authorize the arbitral tribunal to decide *ex aequo et bono* (as *amiable compositeur*), there was no reason to deny the parties the right to agree on rules of law which offered more certainty than the rules to be applied in an *ex aequo et bono* arbitration.

233. Under another view, article 28 (1) should limit itself to providing that a dispute shall be decided in accordance with the law chosen by the parties. That was in line with the solution adopted in many international texts on arbitration (e.g. 1961 Geneva Convention, 1966 ECAFE Rules for International Commercial Arbitration and Standards for Conciliation, 1976 UNCITRAL Arbitration Rules, 1975 ICC Rules). That traditional approach provided a greater degree of certainty than the novel and ambiguous notion of "rules of law", which might cause considerable difficulties in practice. It was not appropriate for a model law designed for universal application to introduce a concept which was not known in, and unlikely to be accepted by, many States. Furthermore, it was stated that the right to select provisions of different laws for different parts of the relationship (the so-called *dépeçage*) was recognized by most legal systems even under the more traditional approach; if there was a need for clarification on that point, the report should express the understanding of the Commission that such a right was included in the freedom of the parties to designate the law applicable to the substance of the dispute.

234. In the light of that discussion the Commission decided to amend the first sentence of paragraph (1) to read as follows: "The arbitral tribunal shall decide the dispute in accordance with the law chosen by the parties as applicable to the substance of the dispute." It was agreed that the formulation would allow parties to designate portions of the legal systems from different States to govern different aspects of their relationship. It was also agreed to state in the report that States when enacting the model law were free to give the term "law" a wider interpretation. It was understood that parties might agree in their contracts to apply rules such as those in international conventions not yet in force.

235. As regards the second sentence of paragraph (1), it was agreed that the rule of interpretation of the parties' designation of the law of a given State was useful in that it made clear that, unless otherwise expressed in such agreement, the dispute was to be decided in accordance with the substantive law of that State and not by the substantive law as determined by the conflict of laws rules of that State.

236. In the subsequent discussion on paragraph (2), views were divided as to whether the arbitral tribunal should be required to apply conflict of laws rules which it considered applicable in order to determine the substantive law to be applied or whether it could directly determine the applicable law it considered appropriate in the particular case. Under one view, the Model Law should provide guidance to the arbitral tribunal by providing that the applicable law was to be determined by a decision on the applicable conflict of laws rules. It was noted that, although a court, under the Model Law and most national laws, could not review the decision of the arbitral tribunal on the conflict of laws rules and consequently on the applicable substantive law, a desirable effect of the rule contained in paragraph (2) was that the arbitral tribunal would be expected to give reasons for its decision on the choice of the conflict of laws rule. Furthermore, that approach would provide the parties with a greater degree of predictability or certainty than the approach of allowing the arbitral tribunal to determine directly the law applicable to the substance of the dispute.

237. Under another view, it was not appropriate to limit the power of the arbitral tribunal to decide on the law applicable to the substance of the dispute by requiring it to decide first on an existing conflict of laws rule. In practice an arbitral tribunal did not necessarily first decide on conflict of laws rules but often arrived at a decision on substantive law by more direct means. It was suggested that it would not be appropriate for a model law on international commercial arbitration to disregard such practices which developed on the basis of a broad scope of party autonomy recognized in many legal systems. Furthermore, it was doubtful whether the requirement of applying first a conflict of laws rule would, in fact, provide a higher degree of certainty than a direct determination of the governing law since, on the one hand, the conflict of laws rules often differed from one legal system to another and since, on the other hand, the reasons which led the arbitral tribunal to select the appropriate applicable law were often similar to the connecting factors used in conflict of laws rules. It was also pointed out that the freedom of the arbitral tribunal under paragraph (2) should not be narrower than the one accorded to the parties under paragraph (1).

238. In view of the division of views on paragraphs (1) and (2), it was suggested that article 28 might be deleted since it was not necessary for a law on arbitral procedure to deal with the law relative to the substance of the dispute. Moreover, since the Model Law did not provide for court review of an award on the ground of wrong application of article 28, it served as little more than a guideline for the arbitral tribunal. However, there was wide support in the Commission for retaining article 28. It was pointed out that the Model Law would be incomplete without a provision on rules applicable to the substance of disputes, particularly in view of the fact that the Model Law dealt with international commercial arbitration where a lack of rules on that issue would give rise to uncertainty.

239. The Commission, after deliberation, decided to reverse its previous decision in respect of paragraph (1) and to adopt the original texts of paragraphs (1) and (2).

Paragraph (3)

240. The Commission adopted the text of paragraph (3).

New paragraph to be added to article 28

241. The Commission decided to include in article 28 a provision modelled on article 33 (3) of the UNCITRAL Arbitration Rules as follows: "In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction."

Freedom to authorize third person to determine applicable law

242. The Commission recalled a suggestion made in the context of article 2 (c) that the freedom of the parties to authorize a third person to determine a certain issue did not extend to the determination of the rules of law applicable to the substance of the dispute (see above, para. 40). It was agreed to make clear that article 2 (c) did not apply to article 28.

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Article 29.

Decision-making by panel of arbitrators

243. The text of article 29 as considered by the Commission was as follows:

"In arbitral proceedings with more than one arbitrator, any decision of the arbitral tribunal shall be made, unless otherwise agreed by the parties, by a majority of all its members. However, the parties or the arbitral tribunal may authorize a presiding arbitrator to decide questions of procedure."

244. It was suggested that article 29 should empower a presiding arbitrator, if no majority could be reached, to decide as if he were a sole arbitrator. The Commission did not adopt the suggestion since it might, under certain circumstances, lend itself to precluding the other members of the arbitral tribunal from having an appropriate influence on the decision-making. It was noted that parties who preferred that solution were free to agree thereon, since the provision was of a non-mandatory character.

245. The Commission decided to express in the second sentence of article 29 that a decision of the arbitral tribunal to authorize a presiding arbitrator to decide questions of procedure had to be unanimous. Subject to that modification, which was referred to the Drafting Group, the Commission adopted article 29.

246. It was noted that it was implicit in the Model Law that, subject to contrary agreement, arbitrators might

make decisions without necessarily being present at the same place.

* * *

Article 30.

Settlement

247. The text of article 30 as considered by the Commission was as follows:

"(1) If, during arbitral proceedings, the parties settle the dispute, the arbitral tribunal shall terminate the proceedings and, if requested by the parties and not objected to by the arbitral tribunal, record the settlement in the form of an arbitral award on agreed terms.

"(2) An award on agreed terms shall be made in accordance with the provisions of article 31 and shall state that it is an award. Such an award has the same status and effect as any other award on the merits of the case."

248. A proposal was made to delete, in paragraph (1), the words "and not objected to by the arbitral tribunal". It was stated in support that if the parties wanted their settlement to be in the form of an award, rendering it enforceable as an award under the 1958 New York Convention or other applicable procedures, the arbitral tribunal should not be able to disagree.

249. It was stated in reply that a distinction should be drawn between the right of the parties to have the arbitral proceedings terminate as a result of their settlement and their right to have their settlement recorded as an award. It was pointed out that arbitrators should not be forced to attach their signatures to whatever settlement the parties have reached since the terms of such settlement might, in exceptional cases, be in conflict with binding laws or public policy, including fundamental notions of fairness and justice. Furthermore, even if the words were deleted, arbitrators who felt sufficiently strongly that they should not record the settlement in the form of an award might resign. After discussion, the proposal was not adopted.

250. Another proposal was that the request to record the settlement as an award needed to be made by only one of the parties. The Commission, after deliberation, was agreed that there must be the dual will of the two parties that the settlement be recorded as an award, but that the formal request needed to be made by only one of them.

* * *

Article 31.

Form and contents of award

251. The text of article 31 as considered by the Commission was as follows:

"(1) The award shall be made in writing and shall be signed by the arbitrator or arbitrators. In arbitral proceedings with more than one arbitrator, the

signatures of the majority of all members of the arbitral tribunal shall suffice, provided that the reason for any omitted signature is stated.

"(2) The award shall state the reasons upon which it is based, unless the parties have agreed that no reasons are to be given or the award is an award on agreed terms under article 30.

"(3) The award shall state its date and the place of arbitration as determined in accordance with article 20(1). The award shall be deemed to have been made at that place.

"(4) After the award is made, a copy signed by the arbitrators in accordance with paragraph (1) of this article shall be delivered to each party."

Paragraphs (1) and (2)

252. Paragraphs (1) and (2) were adopted.

Paragraph (3)

253. Various views were expressed in respect of a proposal made to amend the second sentence of paragraph (3) to read "The award shall be deemed to have been made at that place and on that date." Under one view the amendment was desirable because it would make the second sentence consistent with the first sentence. Moreover, the date of the award might be significant in a number of different contexts. Since an award might be circulated among the arbitrators by mail for their signature, it might be difficult to know the date of the award. The only date that could be certain was the date on the award, even if that date was a deemed date.

254. Under another view there was a basic difference between the place stated on the award being deemed to be the place of the award and the date stated on the award being deemed to be the date of the award. The former is an irrebuttable presumption to assure the territorial link between the award and the place of arbitration. The latter must be rebuttable, since the arbitrators, as well as the parties, might have reasons for stating the date of the award to be earlier or later than the date it was actually rendered.

255. The Commission, after discussion, did not adopt the proposal.

Date on which award becomes binding

256. It was observed that according to article 36(1)(a) (v) of the Model Law and article V(1)(e) of the 1958 New York Convention, recognition or enforcement of an award might be refused if the award had not yet become binding on the parties and that article 35(1) in dealing with the binding nature of an award did not specify the moment when an award became binding. In the light of that observation it was proposed that the Model Law should define that moment. The Commission considered the following three variants of a possible rule: an arbitral award becomes binding on the parties as of (a) the date on which the award is made, (b) the date on which the award is delivered to the

parties, or (c) the date on which the period of time for making an application for setting aside the award expires.

257. There was general approval of the idea that it would be useful to have such a provision, although some doubt was raised as to whether it was necessary. In that regard it was pointed out that under article 34 (3) the setting aside procedure already specified that it was the date on which the party making the application received the award that commenced the three-month period after which application for setting aside could not be made. There was little agreement as to the date on which the award should become binding. The previous discussion had demonstrated the difficulties of relying either on the date stated on the award or the date of the award. As regards the date on which one or both parties were notified of the award, the practical difficulties of establishing that date in the various factual situations arising in arbitration were described. Moreover, it was difficult to conceive of an award becoming binding on the parties on different dates simply because they were notified of it on different dates.

258. After discussion the Commission did not adopt the proposal.

Res judicata

259. A proposal was made to include in article 31 a provision clarifying that the award made in the form provided in article 31 had the effect of *res judicata*. While not disagreeing with the general principle that awards were binding on the parties, the Commission did not adopt the proposal because it was considered that the term *res judicata* was a complex one which could have different applications in various legal systems.

* * *

Article 32.

Termination of proceedings

260. The text of article 32 as considered by the Commission was as follows:

"(1) The arbitral proceedings are terminated by the final award or by agreement of the parties or by an order of the arbitral tribunal in accordance with paragraph (2) of this article.

"(2) The arbitral tribunal

"(a) shall issue an order for the termination of the arbitral proceedings when the claimant withdraws his claim, unless the respondent objects thereto and the arbitral tribunal recognizes a legitimate interest on his part in obtaining a final settlement of the dispute;

"(b) may issue an order of termination when the continuation of the proceedings for any other reason becomes unnecessary or inappropriate.

"(3) The mandate of the arbitral tribunal terminates with the termination of the arbitral proceedings, subject to the provisions of articles 33 and 34 (4)."

261. The Commission decided to move the reference to the agreement of the parties from paragraph (1) to paragraph (2) so as to make clear that such agreement was a basis for the arbitral tribunal's order for the termination of the arbitral proceedings.

262. Concern was expressed that paragraph (2) (a) might operate unfairly against a claimant in that he might be forced to continue participation in arbitral proceedings although he had good reasons for withdrawing his claim. It was stated in reply that the provision was balanced in that it enabled the arbitral tribunal to meet such concern in a particular case and, in appropriate circumstances, to meet the possible concern of a respondent that the claimant might withdraw his claim at a late stage of the proceedings and then compel the respondent to participate in other proceedings.

263. The Commission was agreed that paragraph (2) (b) should express more clearly that its intended meaning was that the arbitral tribunal had to make a judgement whether the continuation of the arbitral proceedings was unnecessary or inappropriate, but that, when the arbitral tribunal found continuation of the proceedings to be unnecessary or inappropriate, it had to issue an order for termination. The Commission was also agreed that the word "inappropriate" in paragraph (2) (b) might be seen as giving too much discretion to the arbitral tribunal and that it should be replaced by a word of a more precise meaning such as "impossible".

264. The Commission adopted article 32, subject to the above modifications which were referred to the Drafting Group.

* * *

Article 33.

Correction and interpretation of awards and additional awards

265. The text of article 33 as considered by the Commission was as follows:

"(1) Within thirty days of receipt of the award, unless another period of time has been agreed upon by the parties, a party, with notice to the other party, may request the arbitral tribunal:

"(a) to correct in the award any errors in computation, any clerical or typographical errors or any errors of similar nature;

"(b) to give an interpretation of a specific point or part of the award.

"The arbitral tribunal shall make the correction or give the interpretation within thirty days of receipt of the request. The interpretation shall form part of the award.

"(2) The arbitral tribunal may correct any error of the type referred to in paragraph (1) (a) of this article on its own initiative within thirty days of the date of the award.

"(3) Unless otherwise agreed by the parties, a party, with notice to the other party, may request, within thirty days of receipt of the award, the arbitral tribunal to make an additional award as to claims presented in the arbitral proceedings but omitted from the award. The arbitral tribunal shall make the additional award within sixty days, if it considers the request to be justified.

"(4) The arbitral tribunal may extend, if necessary, the period of time within which it shall make a correction, interpretation or an additional award under paragraph (1) or (3) of this article.

"(5) The provisions of article 31 shall apply to a correction or interpretation of the award or to an additional award."

266. Divergent views were expressed in respect of a proposal to delete subparagraph (1) (b). Under one view, the provision granting either party the right to request an interpretation of a specific point or of a part of the award might permit parties to open new proceedings in the guise of an interpretation or be used as a means for the losing party to harass the arbitral tribunal. During the period when a request for interpretation might be made and until the interpretation of the award had been given by the arbitral tribunal, the finality of the award was disturbed and some questions were raised as to the interrelationship with setting aside proceedings by the losing party or enforcement proceedings by the winning party.

267. Under another view it would be too rigid not to allow for some procedure of interpretation of the award by the arbitral tribunal. The award might have been written in a language other than the mother tongue of its drafter, increasing the possibility of ambiguity. If the award was too ambiguous, it might be difficult to enforce it.

268. Several suggestions were made for modification of the provision. It was suggested that, since the word "interpretation" might imply too broad a power to re-examine the dispute, the word "interpretation" might be replaced by "clarification". It was also suggested that an interpretation of only the motives of the award but not its dispositive portion might be allowed. Yet another suggestion was that interpretation of the award by the arbitral tribunal should be allowed only if both parties requested the interpretation.

269. The Commission, after discussion, decided that a request for interpretation might be made only if so agreed by the parties.

270. The Commission adopted the suggestion that the words "if it considers the request to be justified", found in paragraph (3), should also be added to paragraph (1).

271. The Commission was of the view that it was not necessary to indicate any procedural details for the interpretation procedure other than that the other party must be notified of the request. It was noted that article 19 (3), especially if it was set out as a separate article,

would give the basis for assuring procedural regularity and fairness to the parties.

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CHAPTER VII. RECOURSE AGAINST AWARD

Article 34.

Application for setting aside as exclusive recourse against arbitral award

272. The text of article 34 as considered by the Commission was as follows:

"(1) Recourse to a court against an arbitral award made [in the territory of this State] [under this Law] may be made only by an application for setting aside in accordance with paragraphs (2) and (3) of this article.

"(2) An arbitral award may be set aside by the Court specified in article 6 only if:

"(a) the party making the application furnishes proof that:

"(i) the parties to the arbitration agreement referred to in article 7 were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of this State; or

"(ii) the party making the application was not given proper notice of the appointment of the arbitrator(s) or of the arbitral proceedings or was otherwise unable to present his case; or

"(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or

"(iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Law from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Law; or

"(b) the Court finds that:

"(i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or

"(ii) the award or any decision contained therein is in conflict with the public policy of this State.

"(3) An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the award or, if a request had been made under article 33, from the date on which that request had been disposed of by the arbitral tribunal.

"(4) The Court, when asked to set aside an award, may, where appropriate and so requested by a party, suspend the setting aside proceedings for a period of time determined by it in order to give the arbitral tribunal an opportunity to resume the arbitral proceedings or to take such other action as in the arbitral tribunal's opinion will eliminate the grounds for setting aside."

273. The Commission was agreed that the Model Law should regulate the setting aside of arbitral awards and decided to retain provisions along the lines of article 34.

Paragraph (1)

274. The Commission adopted the principle underlying paragraph (1) to provide for one exclusive type of recourse against an arbitral award. It was understood that the application for setting aside was exclusive in the sense that it constituted the only means for actively attacking the award. A party was not precluded from defending himself by requesting refusal of recognition or enforcement in proceedings initiated by the other party.

275. An observation was made that the words "Recourse to a court" were too vague and that they might be made more precise by adding such words as "competent for arbitration matters".

276. As regards the words placed between square brackets "[in the territory of this State] [under this Law]", it was noted that they addressed the question of the territorial scope of application which the Commission had discussed at an earlier stage (see above, paras. 72-81). In conformity with the clearly prevailing view, the Commission was agreed that the Court of the given State, which enacted the Model Law, was competent for setting aside those awards made in its territory. It was agreed to determine at a later stage, when the final wording of a general provision on the territorial scope of application of the Model Law would be considered, whether the territorial restriction should be expressed in article 34 or whether the general provision sufficed. Subsequently, in light of the adoption of article 1 (1 *bis*) containing a general provision on the territorial scope of application of the Model Law (see above, para. 81), the Commission decided that an expression of the territorial restriction in article 34 was not necessary. It was noted that the adoption of the so-called strict territorial criterion did not preclude parties from selecting the procedural law of a State other than that of the place of arbitration, provided that the selected provisions were not in conflict with the mandatory provisions of the (Model) Law in force at the place of arbitration.

Paragraph (2)

Concern about restrictive list of grounds

277. Concern was expressed that the list of grounds on which an award may be set aside under paragraph (2) might be too restrictive to cover all cases of procedural injustice where annulment was justified. To illustrate the point, it was questioned whether the following cases were covered by any of the grounds set forth in article 34 (2), more specifically subparagraphs (a) (ii) and (iv), read together with article 19 (3), or subparagraph (b) (ii): 1. the award was founded on evidence which was proved or admitted to have been perjured; 2. the award was obtained by corruption of the arbitrator or of the witnesses of the losing party; 3. the award was subject to a mistake, admitted by the arbitrator, of a type which did not fall within article 33 (1) (a); 4. fresh evidence had been discovered that could not have been discovered by the exercise of due diligence during the arbitral proceedings, which demonstrated that through no fault on the part of the arbitrator the award was fundamentally wrong. It was suggested that, unless the Commission was agreed that such serious instances of procedural injustice were covered by paragraph (2) and the understanding was clearly reflected in the report of the session and any commentary on the final text, the provision should be modified by appropriate wording so as to cover those instances.

278. Another suggestion was to make the list of grounds non-exhaustive so as to allow for future inclusion of worthy cases which might not be foreseeable by the Commission.

279. The Commission postponed its consideration of the above concern and suggestions until after it had examined the grounds set forth in paragraph (2). As fully discussed during that later consideration (see below, paras. 298-302) and known from the deliberations of the Working Group, there were divergent opinions on whether or to what extent the concern was met by the existing text or should be met by additional wording. One view was, for example, that only some and not all of the grounds presented in the above illustrative cases justified setting aside an award.

Subparagraph (a) (i)

280. As regards the first ground set forth in the subparagraph, it was suggested that the wording, which was taken from article V (1) (a) of the 1958 New York Convention, was unsatisfactory in two respects. First, the reference to "the parties" was inappropriate since it sufficed that one of the parties lacked the capacity to conclude an arbitration agreement. Second, the words "under the law applicable to them" were inappropriate in that they appeared to contain a conflict of laws rule which in fact was either incomplete or misleading in that the rule might be understood as referring to the law of the nationality, domicile or residence of the parties. It was, therefore, proposed to modify the wording of the first ground along the following lines: "a party to the arbitration agreement referred to in article 7 lacked the capacity to conclude such an agreement".

281. In response to that proposal, it was stated that it was unnecessary and even dangerous to deviate from the wording embodied in the 1958 New York Convention and other international texts on arbitration such as the 1961 Geneva Convention. It was unnecessary since the original wording did not appear to have led to considerable difficulties or disparities and certainly had not led in general to an interpretation different from the one aimed at by the proposed clarification. The deviation was dangerous in that it might lead to divergent interpretations, based on the different wordings, in an issue which should be dealt with in a uniform manner.

282. The Commission, after deliberation, decided to adopt the proposal. It was noted that in the context of article 34 the need for harmony with the 1958 New York Convention was less strong than in the context of article 36.

283. As regards the second ground set forth in subparagraph (a) (i), a proposal was made to substitute the words "or there is no valid arbitration agreement" for the words "or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of this State". It was pointed out that the conflict of laws rule contained in that latter wording, which was taken from the 1958 New York Convention, was inappropriate in that it declared as applicable, failing a choice of law by the parties, the law of the place of arbitration. The place of arbitration, however, was not necessarily connected with the subject-matter of the dispute. It was unjustified to let the law of that State determine the issue with global effect, which would be the effect of a setting aside by virtue of article 36 (1) (a) (v) of the Model Law or article V (1) (e) of the 1958 New York Convention; it was also said that such a result would be in conflict with a modern trend to determine the issue in accordance with the law of the main contract.

284. It was stated in reply that it was preferable to retain the present text not simply because it was the wording of the 1958 New York Convention but also because the rule was in substance a sound one. It was pointed out that the rule recognized party autonomy, which was important in view of the fact that some legal systems applied the *lex fori*. Furthermore, to use the place of arbitration as a secondary criterion was beneficial in that it provided the parties with a degree of certainty which was lacking under the proposed formula. There were also doubts as to whether in fact a trend could be discerned in favour of determining the question of the validity of the arbitration agreement according to the law of the main contract.

285. The Commission, after deliberation, did not adopt the proposal. Accordingly, subparagraph (a) (i) was adopted in its original form, subject to modifying the first ground along the following lines: "a party to the arbitration agreement referred to in article 7 lacked the capacity to conclude such an agreement".

Subparagraph (a) (ii)

286. The Commission decided to replace in subparagraph (a) (ii) the words "appointment of the arbitrator(s)" by the words "appointment of an arbitrator". It was understood that in arbitral proceedings with more than one arbitrator, failure to give proper notice of the appointment of any one of them constituted a ground for setting aside an award.

287. As regards the ground that a party "was otherwise unable to present his case", it was suggested that the wording should be aligned with that used in article 19 (3). The Commission accepted the suggestion but postponed its implementation until after a decision was reached in respect of article 19 (3). It was suggested, in that connection, that the alignment, coupled with the inclusion of the second principle embodied in article 19 (3), could go a long way towards meeting the above expressed concern about the restrictive list of grounds contained in paragraph (2) (see above, para. 277). (See, however, below, para. 302.)

Subparagraph (a) (iii)

288. In the context of the discussion of the subparagraph, a suggestion was made to clarify, either in that article or in article 16, that a party who had failed to raise a plea as to the jurisdiction of the arbitral tribunal in accordance with article 16 (2) would be precluded from relying on such objection in setting aside proceedings. It was noted that the same question of preclusion or waiver arose with regard to other grounds set forth in article 34 (2) (a), in particular subparagraph (a) (i). It was recognized that the failure to raise such plea could not have the effect of a waiver in all circumstances, especially where the plea under subparagraph (2) (b) was that the dispute was non-arbitrable or that the award was in conflict with public policy.

289. The Commission decided not to embark on an in-depth discussion with a view to elaborating a comprehensive provision covering all eventualities and details. It was agreed not to modify the text and, thus, to leave the question to the interpretation, and possibly regulation, by the States adopting the Model Law.

Subparagraph (a) (iv)

290. As regards the standards set forth in the subparagraph, it was understood that priority was accorded to the agreement of the parties. However, where the agreement was in conflict with a mandatory provision of "this Law" or where the parties had not made an agreement on the procedural point at issue, the provisions of "this Law", whether mandatory or not, provided the standards against which the composition of the arbitral tribunal and the arbitral procedure were to be measured. The Commission requested the Drafting Group to consider whether that understanding was clearly expressed by the current wording of the subparagraph.

Subparagraph (b) (i)

291. Divergent views were expressed as to the appropriateness of the provision. Under one view, the provision should be deleted since it declared as applicable to the question of arbitrability the law of the State where the award was made. That solution was not appropriate in view of the fact that the place of arbitration might not be connected in any way with the transaction of the parties or the subject-matter of their dispute. The solution was not acceptable in the context of article 34 since a decision to set aside the award had effect *erga omnes*.

292. Under another view, the provision should be retained without that or any other conflict of laws rule. It was stated in support that, while the conflict of laws rule set forth in the provision was not appropriate, non-arbitrability had to be maintained as a ground for setting aside. It was noted that, if the entire subparagraph (b) (i) were deleted, the question of arbitrability would, in certain legal systems, be regarded as a matter concerning the validity of the arbitration agreement (under subparagraph (a) (i)) and by others as a matter of public policy of "this State" under subparagraph (b) (ii).

293. Under yet another view, the provision should be retained in its current form. It was stated in support that deletion of the entire provision or of the conflict of laws rule would be contrary to the need for predictability and certainty in that important issue. It was noted that parties could in fact achieve that goal by selecting a suitable place of arbitration and, thus, the governing law.

294. The Commission, after deliberation, adopted the latter view and retained the provision in its current form.

Subparagraph (b) (ii)

295. It was proposed that the provision should be deleted since the term "public policy" was too vague and because it did not constitute a justified ground for setting aside, while it might be appropriate in the context of article 36.

296. In discussing the term "public policy", it was understood that it was not equivalent to the political stance or international policies of a State but comprised the fundamental notions and principles of justice. It was noted, however, that in some common law jurisdictions that term might be interpreted as not covering notions of procedural justice while in legal systems of civil law tradition, inspired by the French concept of "*ordre public*", principles of procedural justice were regarded as being included. It was observed that the divergence of interpretation might have contributed to the above expressed concern that the list of reasons in paragraph (2) did not cover all serious instances of procedural injustice (see above, para. 277).

297. The Commission, after deliberation, was agreed that the provision should be retained, subject to

deletion of the words "or any decision contained therein", which were superfluous. It was understood that the term "public policy", which was used in the 1958 New York Convention and many other treaties, covered fundamental principles of law and justice in substantive as well as procedural respects. Thus, instances such as corruption, bribery or fraud and similar serious cases would constitute a ground for setting aside. It was noted, in that connection, that the wording "the award is in conflict with the public policy of this State" was not to be interpreted as excluding instances or events relating to the manner in which an award was arrived at.

Suggestions for widening the scope of paragraph (2)

298. After having examined the grounds contained in paragraph (2), the Commission continued its consideration of the above concerns and suggestions as to the restrictive list of grounds (above, paras. 277-278). It was agreed that the list of grounds should retain its exclusive character for the sake of certainty.

299. Thus, considering whether any ground should be added, divergent views were expressed as to the need for such addition. Under one view, there was a need for adding wording to subparagraph (a) (ii) which would cover instances of serious departure from fundamental principles of procedure. Under another view, there was a need for establishing a separate régime, providing for a considerably longer period of time than the one set forth in article 34 (3), for such cases as fraud or false evidence which had materially affected the award.

300. Under yet another view, there was no need for any addition in view of the understanding agreed to by the Commission as regards the ground set forth in subparagraph (b) (ii). In reply to the suggestion for allowing a considerably longer period of time in which to apply for setting aside an award on the grounds of fraud, or that evidence was false or discovered only later, it was stated that such extension was contrary to the need for speedy and final settlement of disputes in international commercial relationships.

301. The Commission, after deliberation, decided to incorporate in subparagraph (a) (ii) the text of article 19 (3).

302. In connection with the subsequent decision to transfer the provision of article 19 (3) to the beginning of chapter V of the Model Law as a separate article 18 *bis* (see above, para. 176), the Commission reversed its decision to incorporate in subparagraph (a) (ii) the text of article 19 (3) and restored the text of subparagraph (a) (ii) as it had been elaborated by the Working Group. The reasons for the restoration of the text of subparagraph (a) (ii) were that the alignment between articles 34 and 36 was thought to be more important than the alignment between articles 34 and 18 *bis* and that it was the Commission's understanding that, in spite of the resulting difference between the text of article 18 *bis* and article 34 (2) (a) (ii), any violation of article 18 *bis* would constitute a ground for setting aside

the award under article 34 (2) subparagraph (a) (ii), subparagraph (a) (iv) or subparagraph (b) and that the concerns which led to the proposal to amend subparagraph (a) (ii) were, therefore, already met.

303. It was understood that an award might be set aside on any of the grounds listed in paragraph (2) irrespective of whether such ground had materially affected the award.

Paragraph (3)

304. The Commission did not adopt a proposal to make the period of time set forth in paragraph (3) subject to contrary agreement by the parties. The Commission adopted paragraph (3) in its current form.

Paragraph (4)

305. Divergent views were expressed as to the appropriateness of the provision. Under one view, the paragraph should be deleted since it dealt with a procedure which was of limited practical relevance and known only in certain legal systems. Furthermore, the provision was obscure, in particular, as regards the relationship between the court and the arbitral tribunal and as regards the scope of the function expected from the arbitral tribunal in a case of remission. In that respect, it was proposed that, if the provision were to be retained, it should be restricted to defects which were remediable without reopening the proceedings or that guidelines should be elaborated as to the steps expected from the arbitral tribunal.

306. The prevailing view, however, was that the provision should be retained. The mere fact that the procedure of remitting the award to the arbitral tribunal was not known in all legal systems was no compelling reason for excluding it from the realm of international commercial arbitration where it should prove useful and beneficial. It was pointed out in support that the procedure, where found appropriate by the court, would enable the arbitral tribunal to cure certain defects which otherwise would necessarily lead to the setting aside of the award. Furthermore, the general wording of paragraph (4) was advantageous in that it provided the court and the arbitral tribunal sufficient flexibility to meet the needs of the particular case.

307. The Commission did not adopt a proposal to delete the requirement that the remission procedure of the paragraph must be requested by a party. After deliberation, the Commission adopted the paragraph in its current form.

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CHAPTER VIII. RECOGNITION AND ENFORCEMENT OF AWARDS

308. Divergent views were expressed as to whether the Model Law should contain provisions on the recognition and enforcement of both domestic and foreign awards.

Under one view, the draft chapter on recognition and enforcement should be deleted. It was not appropriate to retain in the Model Law provisions which would cover foreign awards, in view of the existence of widely adhered-to multilateral treaties such as the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. It was stated that those States which had not ratified or acceded to that Convention should be invited to do so, but that a State which decided not to adhere to that Convention was unlikely to adopt the almost identical rules laid down in articles 35 and 36. It was pointed out that provisions on recognition and enforcement of foreign awards were not needed by those States which adhered to the 1958 New York Convention. In addition, such provisions in the Model Law might cast doubt on the effect of the reciprocity reservation made by many member States and might create other difficulties in the application of the Convention. Furthermore, retention in the Model Law of provisions on enforcement of domestic awards raised problems of co-ordination with the provisions on setting aside in article 34 and, in some States at least, were unnecessary in view of the existing law, which treated domestic awards as self-enforcing by equating them with judgements of local courts.

309. The prevailing view, however, was to retain provisions covering both domestic and foreign awards. It was pointed out that the existence and generally satisfactory operation of the 1958 New York Convention, to which many States adhered, was no compelling reason for deleting the draft chapter on recognition and enforcement. There were a great number of States, in fact a majority of all States members of the United Nations, that had not ratified or acceded to that Convention. Some of those States might, for constitutional or other reasons, find it easier to adopt the provisions on recognition and enforcement as part of the Model Law than to ratify or accede to that Convention. A model law on arbitration would be incomplete if it lacked provisions on such an important subject as recognition and enforcement of arbitral awards. As regards those States that were parties to that Convention, the draft chapter might provide supplementary assistance by providing a régime for non-convention awards, without adversely affecting the operation of that Convention. It was pointed out, in that respect, that the Model Law, as expressed in its article I (1), was subject to any such treaty, that any State adopting the Model Law could consider incorporating certain restrictions, for instance, based on the idea of reciprocity, and that articles 35 and 36 were closely modelled on the provisions of that Convention. Furthermore, the concept of uniform treatment of all awards irrespective of the country of origin was beneficial for the functioning of international commercial arbitration.

310. The Commission, after deliberation, decided to retain in the Model Law the chapter on recognition and enforcement of awards, irrespective of where they were made. It was noted that it was compatible with that decision and in fact desirable to invite the General Assembly of the United Nations to recommend to those

States that had not already done so to consider adhering to the 1958 New York Convention.

* * *

Article 35.

Recognition and enforcement

311. The text of article 35 as considered by the Commission was as follows:

"(1) An arbitral award, irrespective of the country in which it was made, shall be recognized as binding and, upon application in writing to the competent court, shall be enforced subject to the provisions of this article and of article 36.

"(2) The party relying on an award or applying for its enforcement shall supply the duly authenticated original award or a duly certified copy thereof, and the original arbitration agreement referred to in article 7 or a duly certified copy thereof. If the award or agreement is not made in an official language of this State, the party shall supply a duly certified translation thereof into such language.*

"(3) Filing, registration or deposit of an award with a court of the country where the award was made is not a pre-condition for its recognition or enforcement in this State."

*The conditions set forth in this paragraph are intended to set maximum standards. It would, thus, not be contrary to the harmonization to be achieved by the Model Law if a State retained even less onerous conditions."

Paragraph (1)

312. It was noted that the scope of application of articles 35 and 36 was not identical to that of the 1958 New York Convention and that the classification of awards was not the same as in that Convention. Articles 35 and 36 covered only those awards arising out of an international commercial arbitration in the terms of article 1, even as regards awards made in a foreign State. It was understood that that did not mean that the State in which the award was made must have itself adopted the Model Law in order for those provisions to apply to the enforcement of the award.

313. It was noted that article 35 (1) did not determine the point of time when an award became binding. As regards foreign arbitral awards, that question would have to be answered, in conformity with the rule laid down in article 36 (1) (a) (v), by the law of the State in which, or under the law of which, the award was made. As regards awards made in the State where recognition or enforcement is sought under article 35, the discussion of that issue was subsequently held in the context of article 31 (see above, paras. 256-258).

314. The Commission adopted the paragraph.

Paragraph (2)

315. The Commission adopted the paragraph.

Paragraph (3)

316. It was suggested that the question as to whether an award must be filed, registered or deposited should be left to each State. It was also suggested that it would be inconsistent for a State to require awards to be registered but to enforce those awards even though they were not registered.

317. The Commission deleted the paragraph.

* * *

Article 36.

Grounds for refusing recognition or enforcement

318. The text of article 36 as considered by the Commission was as follows:

"(1) Recognition or enforcement of an arbitral award, irrespective of the country in which it was made, may be refused only:

"(a) at the request of the party against whom it is invoked, if that party furnishes to the competent court where recognition or enforcement is sought proof that:

"(i) the parties to the arbitration agreement referred to in article 7 were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or

"(ii) the party against whom the award is invoked was not given proper notice of the appointment of the arbitrator(s) or of the arbitral proceedings or was otherwise unable to present his case; or

"(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or

"(iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

"(v) the award has not yet become binding on the parties or has been set aside or suspended by a court of the country in which, or under the law of which, that award was made; or

"(b) if the court finds that:

"(i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or

"(ii) the recognition or enforcement of the award would be contrary to the public policy of this State.

"(2) If an application for setting aside or suspension of an award has been made to a court referred to in paragraph (1) (a) (v) of this article, the court where recognition or enforcement is sought may, if it considers it proper, adjourn its decision and may also, on the application of the party claiming recognition or enforcement of the award, order the other party to provide appropriate security."

319. The Commission rejected a proposal that article 36 should be made applicable only to international commercial arbitration awards made in a State other than "this State". It was felt that the general policy decision to retain chapter VIII on recognition and enforcement applicable to awards irrespective of where they were made should be confirmed.

Paragraph (1)

320. The suggestion was made that article 36 should be interpreted in the sense that an award would not be recognized where the court found that the arbitral tribunal had proceeded without jurisdiction or had infringed the exclusive jurisdiction of the court before which the recognition or enforcement was sought. It was suggested that that matter might have become of greater importance in light of the Commission's decision in respect of article 1 (2) (c) that an arbitration was international if the parties had expressly agreed that the subject-matter of the arbitration agreement related to more than one country.

321. The Commission adopted the proposal to modify article 36 (1) (a) (i) to conform to the change previously made in article 34 (2) (a) (i). The change involved replacing the words "the parties" with the words "a party" and the words "were, under the law applicable to them, under some incapacity," with such words as "lacked the capacity to conclude such an agreement". The Commission adopted the suggestion for the purpose of maintaining textual harmony between articles 34 and 36. However, the Commission expressed the view that the modification did not entail any substantive discrepancy between article 36 (1) (a) (i) and the corresponding provision in the 1958 New York Convention.

322. The Commission decided, in line with its decision on article 34 (2) (a) (ii) (above, para. 286), to replace in subparagraph (1) (a) (ii) the words "appointment of the arbitrator(s)" by the words "appointment of an arbitrator".

323. It was proposed that subparagraph (b) (ii) be deleted since in some common law jurisdictions the term "public policy" might be interpreted as not covering notions of procedural justice. However, the Commission was agreed that the subparagraph should be retained under the same understanding which the Commission expressed in connection with article 34 (2) (b) (ii) (see above, paras. 296-297).

324. Paragraph (1) was adopted with the modifications indicated above.

Paragraph (2)

325. The Commission adopted the paragraph.

* * *

D. Discussion of other matters

Article headings

326. The Commission decided to retain the footnote annexed to the heading of article 1 in order to inform the recipients of the Model Law about the understanding of the Commission that article headings were for reference purposes only and were not to be used for purposes of interpretation.

Counter-claim

327. The Commission recalled a suggestion made in the context of article 23 for adding a new provision that any provision of the Model Law referring to the claim would apply, *mutatis mutandis*, to a counter-claim (see above, para. 201). On the basis of a proposal prepared by the representatives of Czechoslovakia and the United States, the Commission decided to add the following provision to article 2 as new subparagraph (f):

"(f) where a provision of this Law, other than in articles 25 (a) and 32 (2) (a), refers to a claim, it also applies to a counter-claim, and where it refers to a defence, it also applies to a defence to such counter-claim."

Burden of proof

328. It was proposed to make clear in the Model Law that each party was to have the burden of proving the facts relied on to support his claim or defence. In support of the proposal it was stated that, absent such clarification, some parties might not be diligent or some arbitral tribunals might misconceive their role as being investigatory. The Commission decided not to include in the Model Law a provision on that point. In support of the decision it was stated that certain aspects of burden of proof might be regarded to be issues of substantive law and therefore subject to the provisions of article 28; moreover, such a provision could unnecessarily interfere with the general principle of article 19, according to which it was for the parties, and subordinately for the arbitral tribunal, to determine the rules of procedure. However, it was understood that it was a generally recognized principle that reliance of a party on a fact in support of his claim or defence required that party to prove the fact.

Evidence of witnesses

329. A proposal was made to provide in the Model Law that evidence of witnesses might also be presented in the form of written statements signed by them, since it would be useful if the Model Law dispelled any doubt

about that cost-saving, and sometimes the only available, method of taking evidence of witnesses. The Commission did not adopt the proposal since it was considered better to leave a point of detail like the one proposed under the aegis of the general principle of article 19.

Reciprocal application of articles 35 and 36

330. A proposal was made to include in article 35, or in a footnote to article 35, an indication that, following the example of the 1958 New York Convention, articles 35 and 36 might be made subject to the condition of reciprocity as regards the recognition and enforcement of foreign arbitral awards. However, in response to the proposal it was stated that the idea of reciprocity might be appropriate in a convention but was not desirable in a unification by way of a model law. It was also stated that, since a reciprocity provision would have to be a detailed one specifying what kind of reciprocity was meant and it would be difficult to agree on a unified approach to the question, it was better to leave the formulation of any reciprocity provision to each State adopting the Model Law. The Commission, after deliberation, adopted the view that, while the use of territorial links in international commercial arbitration should not be promoted, each State that wanted to subject the application of the provisions on recognition or enforcement of foreign awards to a requirement of reciprocity should express the requirement in its legislation, specifying the basis or connecting factor and the technique used by it.

E. Consideration of the draft articles by the Drafting Group

331. After consideration of the individual articles of the draft Model Law by the Commission, they were submitted to the Drafting Group for implementation of the decisions taken by the Commission and revision to ensure consistency within the text and between language versions. In the final version, all article numbers were maintained, with the following exceptions: article 2 (e) was placed in a separate article, numbered as article 3, article 14 *bis* was incorporated into article 14 as its paragraph (2), article 18 was renumbered as article 17, and article 19 (3) was placed in a separate article, numbered as article 18.

F. Adoption of the Model Law

332. The Commission, after consideration of the text of the draft Model Law as revised by the Drafting Group, at its 333rd meeting on 21 June 1985 decided to adopt the UNCITRAL Model Law on International Commercial Arbitration as it appears in Annex I to this report.

333. The Commission invited the General Assembly to recommend to States that they should consider the Model Law when they enact or revise their laws to meet the current needs of international commercial arbitration and to request the Secretary-General to send the text of the Model Law, together with the *travaux préparatoires* from the current session of the Com-

mission, to Governments and to arbitral institutions and other interested bodies such as chambers of commerce.

Chapter III. International payments

A. Draft Convention on International Bills of Exchange and International Promissory Notes⁹

334. The United Nations Commission on International Trade Law, at its seventeenth session in 1984, considered the draft Convention on International Bills of Exchange and International Promissory Notes as prepared by the Working Group on International Negotiable Instruments and contained in document A/CN.9/211. As regards its future course of action, the Commission decided that further work should be undertaken with a view to improving the draft Convention and entrusted that work to the Working Group on International Negotiable Instruments.¹⁰

335. The mandate of the Working Group was to revise the draft Convention on International Bills of Exchange and International Promissory Notes in the light of decisions and discussion at the seventeenth session of the Commission,¹¹ and also taking into account those comments of Governments and international organizations in documents A/CN.9/248 and A/CN.9/249/Add.1 which were not discussed at that session.

336. The Commission, at its current session, had before it the report of the Working Group on the work of its thirteenth session, held in New York from 7 to 18 January 1985 (A/CN.9/261). The Commission agreed that, in the light of the progress made in solving the major controversial issues, namely the concepts of holder and protected holder, the effect of forged endorsements and the liability of the transferor by mere delivery or by endorsement, it was reasonable to request the Working Group to complete the consideration of the major controversial issues and, to the extent possible, the remaining issues, with a view to submitting a draft to the Commission in a form suitable for consideration at its nineteenth session.

337. However, in view of the fact that the Working Group might not have sufficient time to reformulate the draft in such a form in one session planned for 9 to 20 December 1985, the Commission also agreed that the Working Group might hold an additional session in February or March 1986, or might complete its mandate by other appropriate means.

⁹The Commission considered this subject at its 331st meeting, on 19 June 1985.

¹⁰Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 88.

¹¹The discussion and conclusions on major controversial and other issues are set forth in the report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), paras. 21-82.

338. It was suggested that when the Commission, at its nineteenth session, considers the draft Convention, which would have been prepared by the Working Group to which all member States of the Commission were invited, as were all other States and interested international organizations, the re-examination of issues that had been thoroughly discussed should be discouraged unless there was evidently substantial ground for such a re-examination.

R. Electronic funds transfers¹²

339. The Commission, at its fifteenth session in 1982, had before it a report of the Secretary-General which considered several legal problems arising out of electronic funds transfers (A/CN.9/221). In the light of those legal problems, the report suggested that, as a first step, the Commission should prepare a guide on the legal problems arising out of electronic funds transfers. The Guide, it was suggested, should be oriented towards providing guidance for legislators or lawyers preparing the rules governing particular systems for such funds transfers.

340. The Commission accepted that recommendation and requested the secretariat to begin the preparation of a legal guide on electronic funds transfers in co-operation with the UNCITRAL Study Group on International Payments.¹³ Several chapters of the draft Legal Guide were submitted to the Commission at its seventeenth session in 1984 for general observations.¹⁴ At the current session the Commission had before it a report of the Secretary-General containing the remaining draft chapters of the Legal Guide (A/CN.9/266 and Add. 1 and 2).

341. The Commission was of the view that the draft Legal Guide was of particular importance because of the existing legal vacuum in that rapidly evolving area of activity. It was noted that there was a close link between the draft Legal Guide and the report on legal security of computer records (A/CN.9/265) and it was suggested that the final version of the Legal Guide should include a chapter on the question of evidence.

342. After discussion, the Commission decided to request the Secretary-General to send the draft Legal Guide on electronic funds transfers to Governments and interested international organizations for comment. It also requested the secretariat, in co-operation with the UNCITRAL Study Group on International Payments, to revise the draft in the light of the comments received for submission to the nineteenth session of the Commission in 1986 for consideration and possible adoption.

¹²The Commission considered this subject at its 328th meeting on 18 June 1985.

¹³Report of the United Nations Commission on International Trade Law on the work of its fifteenth session, *Official Records of the General Assembly, Thirty-seventh Session, Supplement No. 17 (A/37/17)*, para. 73.

¹⁴The draft chapters are to be found in A/CN.9/250/Add.1-4.

Chapter IV. New International Economic Order: industrial contracts¹⁵

343. The Commission had before it the reports of its Working Group on the New International Economic Order on the work of its sixth and seventh sessions (A/CN.9/259 and A/CN.9/262). The reports set forth the deliberations of the Working Group on the basis of the reports and draft chapters of the draft Legal Guide on drawing up international contracts for construction of industrial works which had been prepared by the secretariat (A/CN.9/WG.V/WP.11/Add. 4-5, A/CN.9/WG.V/WP.13 and Add. 1-6 and A/CN.9/WG.V/WP.15 and Add. 1-10).

344. The Commission also had before it a note by the secretariat entitled "Further work of the Commission in the area of international contracts for construction of industrial works" (A/CN.9/268). The note by the secretariat stated that, in view of the fact that the work on the Legal Guide was reaching its concluding stages, the secretariat had given consideration to enhancing the value of the Legal Guide by the preparation of annexes dealing with areas closely related to the construction of industrial works. The note informed the Commission that the Asian-African Legal Consultative Committee (AALCC) had, at its session in Kathmandu, Nepal (6-13 February 1985), recommended that the Commission should consider the preparation of an annex dealing with legal issues related to joint ventures arising in the context of industrial contracts. It had also recommended that the Commission take up concession agreements and other agreements in the field of natural resources. Preliminary consideration had also been given by the secretariat to the preparation of an annex dealing with the area of tendering and procurement in relation to the construction of industrial works. The work so far undertaken on the Legal Guide had suggested that a more detailed examination of the issues involved in procurement and tendering than was possible in the Legal Guide itself might be very valuable. The note indicated the intention of the secretariat to submit to a future session of the Commission a report setting forth proposals on how the value of the Legal Guide might be further enhanced.

345. The Commission took note of the reports of the Working Group on the work of the sixth and seventh sessions and expressed its appreciation to the Working Group for the efficient manner in which the work had been conducted. The Commission requested the Working Group to continue its work expeditiously and to submit a report on the work of its eighth session to the next session of the Commission.

346. The Commission considered the note by the secretariat on further work of the Commission in the area of international contracts for construction of industrial works. The Commission took note of the intention of the secretariat to submit to a future session of the Commission a report setting forth proposals on

¹⁵The Commission considered this subject at its 331st meeting, on 19 June 1985.

how the value of the legal guide might be enhanced by the preparation of some annexes thereto. It was observed that, in the preparation of that report, the secretariat should take into consideration the recommendations made by the Asian-African Legal Consultative Committee which were quoted in the note by the secretariat.

Chapter V. Liability of operators of transport terminals¹⁶

347. The Commission, at its sixteenth session in 1983, decided to include the topic of liability of operators of transport terminals in its programme of work, and to assign work on the preparation of uniform rules on that subject to a working group.¹⁷ At its seventeenth session in 1984, the Commission decided to assign that work to its Working Group on International Contract Practices.¹⁸ The Working Group commenced work on the topic at its eighth session, held at Vienna from 3 to 13 December 1984.

348. The Commission had before it the report of the Working Group on International Contract Practices on the work of its eighth session (A/CN.9/260). The report set forth the deliberations and decisions of the Working Group with respect to its method of work for carrying out the task of preparing uniform rules on the liability of operators of transport terminals, and with respect to issues arising in connection with the subject.

349. The Commission expressed its satisfaction with the work thus far accomplished, expressed its appreciation to the Working Group for the progress made, and requested the Working Group to proceed with its work expeditiously. In view of the particular importance of the secretariat study requested by the Working Group for the next session, the secretariat was requested to prepare the documentation in sufficient time to enable it to be considered by delegations before the beginning of the session.

Chapter VI. Co-ordination of work

A. General co-ordination of activities¹⁹

350. The Secretary of the Commission orally reported on the co-ordination activities in the field of international trade law during the preceding year. He noted

¹⁶The Commission considered this subject at its 331st meeting, on 19 June 1985.

¹⁷Report of the United Nations Commission on International Trade Law on the work of its sixteenth session, *Official Records of the General Assembly, Thirty-eighth Session, Supplement No. 17 (A/38/17)*, para. 115.

¹⁸Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17 (A/39/17)*, para. 113.

¹⁹The Commission considered this subject at its 328th meeting, on 18 June 1985.

that General Assembly resolution 39/82 of 13 December 1984 had reaffirmed "the mandate of the Commission, as the core legal body within the United Nations system in the field of international trade law, to co-ordinate activities in this field in order to avoid duplication of effort and to promote efficiency, consistency and coherence in the unification and harmonization of international trade law". He reported that the designation of the Commission as the core legal body in the field had come to be recognized by other international organizations, both within and outside the United Nations, who regularly turned to the Commission and to its secretariat for leadership in the field.

351. The participation of the large number of other international organizations in the meetings of the Commission and its Working Groups, as reflected in the reports of those meetings, was noted by the Commission. It was recognized that by their participation they contributed their expertise to the development of the Commission's own programme of work. It was also recognized that their participation in the meetings of the Commission served as an effective form of co-ordination of their activities with those of the Commission.

352. The Commission welcomed the continuing contact between the secretariat and other organizations interested in international trade law and urged the secretariat, within the limits of available resources, to strengthen those relationships to the extent possible.

353. It was noted that for the nineteenth session of the Commission the secretariat intended to present a report on current activities of other international organizations in the field of international trade law in general, similar to those presented most recently in 1981 and 1983. In addition, a report would be presented on current activities of other organizations in the field of international commercial arbitration.

B. Legal value of computer records²⁰

354. The Commission at its fifteenth session in 1982 considered a report of the Secretary-General containing a discussion of certain legal problems arising in electronic funds transfers.²¹ In respect of the question of the legal value of computer records, the report concluded: "The problem, while of particular importance to international electronic funds transfers, is one of general concern for all aspects of international trade. Generalized solutions would, therefore, be desirable."²² On the basis of that report the Commission requested the secretariat to submit to some future session a report on the legal value of computer records in general.²³

355. At its seventeenth session in 1984 the Commission decided to place the subject of legal problems

²⁰The Commission considered this subject at its 328th meeting, on 18 June 1985.

²¹A/CN.9/221 (and Corr. 1, French only).

²²*Ibid.*, para. 81.

²³See footnote 13.

arising out of the use of automatic data processing in international trade on the programme of work as a priority item.²⁴ At its current session the Commission had before it a report on the legal value of computer records (A/CN.9/265).

356. As part of the preparation for the report, the secretariat had prepared a questionnaire on the use of computer-readable data as evidence in court proceedings. At the same time and in co-operation with the secretariat of the Commission, the Customs Co-operation Council prepared a questionnaire on the acceptability to customs authorities of a goods declaration in computer-readable form and the subsequent use of such a declaration in court proceedings. The information contained in the replies had been used in the preparation of the report.

357. The report came to the conclusion that on a global level there were fewer problems in the use of data stored in computers as evidence in litigation than might have been expected. Almost all of the countries that replied to the questionnaire appeared to have legal rules which were at least adequate to permit the use of computer records as evidence and to permit the court to make the evaluation necessary to determine the proper weight to be given to the data or document.

358. The report noted that a more serious legal obstacle to the use of computers and computer-to-computer telecommunications in international trade arises out of requirements that documents be signed or that documents be in paper-based form.

Discussion in the Commission

359. The Commission welcomed this first report prepared by the secretariat in implementation of the decision at its seventeenth session to place the subject of legal problems arising out of the use of automatic data processing in international trade on the programme of work as a priority item. The information it contained and the analysis of the problems would aid States in reviewing their legal rules affecting the use of computers and other forms of automatic data processing. The Commission noted that the report had been prepared by the secretariat in co-operation with other international organizations which are interested in the subject and encouraged the secretariat to continue its collaboration with those and other organizations active in the field. In that regard it noted that the secretariat would submit for the nineteenth session a further report in respect of legal aspects of automatic data processing.

Decision

360. After deliberation, the Commission decided to adopt the following recommendation:

The United Nations Commission on International Trade Law,

²⁴Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 136.

Noting that the use of automatic data processing (ADP) is about to become firmly established throughout the world in many phases of domestic and international trade as well as in administrative services,

Noting also that legal rules based upon pre-ADP paper-based means of documenting international trade may create an obstacle to such use of ADP in that they lead to legal insecurity or impede the efficient use of ADP where its use is otherwise justified,

Noting further with appreciation the efforts of the Council of Europe, the Customs Co-operation Council and the United Nations Economic Commission for Europe to overcome obstacles to the use of ADP in international trade arising out of these legal rules,

Considering at the same time that there is no need for a unification of the rules of evidence regarding the use of computer records in international trade, in view of the experience showing that substantial differences in the rules of evidence as they apply to the paper-based system of documentation have caused so far no noticeable harm to the development of international trade,

Considering also that the developments in the use of ADP are creating a desirability in a number of legal systems for an adaptation of existing legal rules to these developments, having due regard, however, to the need to encourage the employment of such ADP means that would provide the same or greater reliability as paper-based documentation,

1. Recommends to Governments:

(a) to review the legal rules affecting the use of computer records as evidence in litigation in order to eliminate unnecessary obstacles to their admission, to be assured that the rules are consistent with developments in technology, and to provide appropriate means for a court to evaluate the credibility of the data contained in those records;

(b) to review legal requirements that certain trade transactions or trade related documents be in writing, whether the written form is a condition to the enforceability or to the validity of the transaction or document, with a view to permitting, where appropriate, the transaction or document to be recorded and transmitted in computer-readable form;

(c) to review legal requirements of a handwritten signature or other paper-based method of authentication on trade related documents with a view to permitting, where appropriate, the use of electronic means of authentication;

(d) to review legal requirements that documents for submission to governments be in writing and manually signed with a view to permitting, where appropriate, such documents to be submitted in computer-readable form to those administrative services which have acquired the necessary equipment and established the necessary procedures;

2. *Recommends* to international organizations elaborating legal texts related to trade to take account of the present Recommendation in adopting such texts and, where appropriate, to consider modifying existing legal texts in line with the present Recommendation.

C. *Current activities of other organizations in the field of transfer of technology*²⁵

361. The Commission, at its fourteenth session in 1981, suggested that the Secretariat should select a particular area of international trade law for detailed consideration as part of its regular report on current activities of international organizations related to the harmonization and unification of international trade law. At its current session the Commission had before it a report of the Secretary-General on the current activities of international organizations within the United Nations system relating to the legal aspects of technology transfer (A/CN.9/269). The Commission took note of the report with appreciation.

Chapter VII. Training and assistance²⁶

362. At its seventeenth session in 1984, the Commission agreed that the sponsorship of regional symposia and seminars on international trade law in general and the activities of the Commission in particular should be continued and strengthened.²⁷ It was stressed that such symposia and seminars were of great benefit to lawyers and businessmen in developing countries. The Commission approved the approach taken by the secretariat in organizing symposia and seminars on a regional basis in collaboration with other organizations.

363. By its resolution 39/82 of 13 December 1984 on the report of the Commission on the work of its seventeenth session, the General Assembly reaffirmed the importance, in particular for the developing countries, of the work of the Commission concerned with training and assistance in the field of international trade law, and the desirability of the Commission sponsoring symposia and seminars organized on a regional basis. The General Assembly also expressed its appreciation to those Governments, organizations and institutions that had collaborated with the secretariat of the Commission in organizing symposia and seminars, and invited Governments, international organizations and institutions to assist the secretariat of the Commission in financing and organizing regional seminars and symposia.

²⁵The Commission considered this subject at its 328th meeting, on 18 June 1985.

²⁶The Commission considered this subject at its 331st meeting, on 19 June 1985.

²⁷Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 141.

364. The Commission had before it a report of the Secretary-General on training and assistance (A/CN.9/270), which described the measures taken by the secretariat to implement the decisions of the Commission and of the General Assembly. The report noted, in particular, the association of the secretariat with the holding of several regional seminars. An Asian-Pacific Regional Trade Law Seminar (Canberra, Australia, 22-27 November 1984) had been conducted by the Attorney-General's Department of Australia, in association with the UNCITRAL secretariat and the Asian-African Legal Consultative Committee. The International Institute for the Unification of Private Law (UNIDROIT) and the Hague Conference on Private International Law also participated. Some of the main subjects emanating from the work of the Commission were discussed. The UNCITRAL secretariat participated in a regional seminar (Dubrovnik, Yugoslavia, 11-23 March 1985) on the international sale of goods (with special reference to the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)) organized by the Inter-University Centre of Postgraduate Studies, Dubrovnik. The Chamber of Commerce of Bogotá, the Iberoamerican Association of Chambers of Commerce, and the UNCITRAL secretariat, with the support of the secretariat of the Organization of American States, organized a regional seminar (Bogotá, Colombia, 22-23 April 1985) on the work of UNCITRAL and international trade law.

365. The report noted that on several occasions other than those mentioned above, the secretariat had participated in symposia and seminars which dealt with the work of the Commission, and that the secretariat intended to keep in touch with Governments and organizations with a view to collaborating with them in organizing symposia and seminars.

366. There was general agreement that the sponsorship of symposia and seminars on international trade law in general, and the activities of the Commission in particular, should be continued and strengthened. It was noted that such symposia and seminars were of great value to young lawyers and government officials from developing countries. During the course of the deliberations it was suggested that the activities on training and assistance would benefit if funds could be assured for the organization by the secretariat of symposia and seminars, and it was suggested that an attempt should be made at an appropriate time to obtain a regular budget allocation for such activities. It was also noted that on two occasions seminars on the activities of the Commission had been organized in connection with an annual session of the Commission and that efforts should be made to organize such seminars in connection with future sessions.

367. The Commission expressed its deep appreciation to all Governments and organizations which had assisted the secretariat in the financing and organization of symposia and seminars. The Commission also expressed its appreciation of the efforts undertaken in this area by the secretariat, and approved the general approach taken by the secretariat towards the organizing of symposia and seminars.

368. Several statements were made concerning proposals for the holding of symposia and seminars in the field of international trade law. The representative of Cuba stated that a seminar devoted to international trade law was planned to be held at Havana in 1987 in collaboration with the UNCITRAL secretariat. It was proposed to consult with the secretariat on the subjects to be considered, and the detailed organization of the seminar. The representative of the Regional Centre for Commercial Arbitration, Cairo, confirmed that a regional seminar on international commercial arbitration would be held, in collaboration with the UNCITRAL secretariat, in Cairo in January 1986. The representative extended an invitation to all delegates and observers present to attend that seminar. The representative of Kenya stated that consideration was being given in collaboration with the UNCITRAL secretariat, for the holding in Nairobi of a symposium dealing with international trade law and the activities of the Commission. The seminar would probably be scheduled for 1986. The representative of Australia stated that a trade law seminar similar to the Asian Pacific Regional Trade Law Seminar held in 1984 was planned to be held in 1988 in connection with Australia's bicentennial celebrations.

Chapter VIII. Status of conventions²⁸

369. The Commission considered the status of conventions that were the outcome of its work, that is, the Convention on the Limitation Period in the International Sale of Goods (New York, 1974) (hereinafter referred to as the Limitation Convention); the Protocol amending the Convention on the Limitation Period in the International Sale of Goods (Vienna, 1980); the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg) (hereinafter referred to as the Hamburg Rules); and the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (hereinafter referred to as the Vienna Sales Convention). The Commission had before it a note by the secretariat on the status of those Conventions, which set forth the status of signatures, ratifications and accessions to them (A/CN.9/271).

370. Several delegations reported on the progress being made within their countries towards ratification of the Vienna Sales Convention, indicating the likelihood that in the near future sufficient ratifications would be obtained to bring the Convention into force. Noting that promising trend, the Secretary of the Commission indicated that he had been informed that many States which were parties to the Convention relating to a Uniform Law on the International Sale of Goods (the Hague, 1964) (hereinafter referred to as the 1964 Hague Convention) were awaiting the entry into force of the Vienna Sales Convention, so that concerted action could be taken by parties to the 1964 Hague Convention to denounce that Convention and become parties to the Vienna Sales Convention.

²⁸The Commission considered this subject at its 328th meeting, on 18 June 1985.

Chapter IX. Relevant General Assembly resolutions, future work and other business²⁹

A. General Assembly resolution on the work of the Commission

371. The Commission took note with appreciation of General Assembly resolution 39/82 of 13 December 1984, on the report of the Commission on the work of its seventeenth session.

B. Date and place of the nineteenth session of the Commission

372. It was decided that the Commission would hold its nineteenth session for four weeks from 16 June to 11 July 1986 in New York. It was noted that the main agenda item of the nineteenth session would be consideration of the draft Convention on International Bills of Exchange and International Promissory Notes, and views were expressed that the Commission should make every effort to complete its work on the draft Convention at that session.

C. Sessions of the Working Groups

373. It was decided that the Working Group on International Negotiable Instruments would hold its fourteenth session from 9 to 20 December 1985 at Vienna and, if an additional session was necessary to put the draft Convention on International Bills of Exchange and International Promissory Notes in a suitable form for consideration by the Commission at its nineteenth session, the fifteenth session would be held in February or March 1986 in New York.

374. It was decided that the Working Group on International Contract Practices would hold its ninth session from 6 to 17 January 1986 in New York.

375. It was decided that the Working Group on the New International Economic Order would hold its eighth session from 17 to 27 March 1986 at Vienna.

D. Dissemination of decisions concerning UNCITRAL legal texts and uniform interpretation of such texts

376. At the sixteenth and seventeenth sessions of the Commission, suggestions were made that means should be explored to disseminate judicial and arbitral decisions concerning legal texts emanating from the work of the Commission.³⁰ At the session of the Sixth Committee held during the thirty-ninth session of the General Assembly, a request was also made that the secretariat

²⁹The Commission considered this subject at its 328th and 331st meetings, on 18 and 19 June 1985.

³⁰Report of the United Nations Commission on International Trade Law on the work of its sixteenth session, *Official Records of the General Assembly, Thirty-eighth Session, Supplement No. 17* (A/38/17), para. 137; Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 155.

submit a paper on that subject to the eighteenth session of the Commission.³¹

377. The Commission had before it a note by the secretariat (A/CN.9/267) which discussed possible mechanisms for the collection and dissemination of decisions relating to legal texts emanating from the work of the Commission, and various measures to promote the uniform interpretation of such texts. The report noted that it might be premature at the present time for the Commission to formulate concrete mechanisms and measures, and suggested that the Commission might wish to consider doing so after the entry into force of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). The Commission decided to defer consideration of the matter to an appropriate future session.

378. In connection with this item, the Secretary of the Commission noted that pursuant to an authorization previously given by the Commission to the UNCITRAL secretariat,³² the secretariat was in the process of

³¹Summary record of the fourth meeting (A/C.6/39/SR.4), para. 28.

³²Report of the United Nations Commission on International Trade Law on the work of its fifteenth session, *Official Records of the General Assembly, Thirty-seventh Session, Supplement No. 17* (A/37/17), paras. 142, 143.

preparing a book on the work of the Commission, including a discussion of the history, mandate, methods of work, and work programme of the Commission, as well as a discussion of the topics worked on by the Commission. The book would reproduce all legal texts adopted by the Commission and would contain a comprehensive list of all UNCITRAL documents.

ANNEX I

UNCITRAL Model Law on International Commercial Arbitration

[Annex reproduced in part three, I, of this *Yearbook*.]

ANNEX II

List of documents of the session

[Annex not reproduced; see check-list of UNCITRAL documents in part three, IV, A, of this *Yearbook*.]

B. United Nations Conference on Trade and Development (UNCTAD): extract from the report of the Trade and Development Board (thirty-first session) (TD/B/1077)*

"B. *Progressive development of the law of international trade: eighteenth annual report of the United Nations Commission on International Trade Law (agenda item 8 (b))*

"918. At the 677th meeting, on 25 September 1985, the President drew attention to the eighteenth annual report of the United Nations Commission on International Trade Law (UNCITRAL) (A/40/17), which had been circulated under cover of document TD/B/1072.

"919. The representative of the USSR, noting that UNCITRAL successfully coped with its task, said that his delegation supported the draft resolution

proposed by UNCITRAL in its annual report for eventual adoption by the General Assembly concerning the draft Model Law on international commercial arbitration. He felt that major attention should be given to the provision contained therein, according to which each State had the right, in case of its adoption of national legislation based on the Model Law, that its provisions concerning recognition and execution of foreign decisions should be based on reciprocity.

"Action by the Board

"920. At the same meeting the Board took note of the report of the United Nations Commission on International Trade Law on its eighteenth session (A/40/17) and of the comments made thereon."

*Official Records of the Trade and Development Board, Thirty-first Session, Supplement No. 1A (TD/B/1077).

C. General Assembly: report of the Sixth Committee (A/40/935)*

1. On the recommendation of the General Committee, the General Assembly decided at its 3rd plenary meeting, on 20 September 1985, to include in the agenda of its fortieth session the item entitled "Report

of the United Nations Commission on International Trade Law on the work of its eighteenth session" and to allocate it to the Sixth Committee.

2. In connection with this item, the Sixth Committee had before it the report in question, which was introduced by the Chairman of the United Nations

*27 November 1985, Official Records of the General Assembly, Fortieth Session, annexes, agenda item 135.

Commission on International Trade Law at the 3rd meeting of the Committee, on 20 September.¹ In addition to that report, the Committee had before it a note by the Secretary-General (A/C.6/40/L.5) relating to the consideration of the report by the Trade and Development Board of the United Nations Conference on Trade and Development.

3. The Sixth Committee considered the item at its 3rd to 5th meetings, from 2 to 7 October and at its 37th and 38th meetings, on 13 and 14 November 1985. The summary records of those meetings (A/C.6/40/SR.3-5, 37 and 38) contain the views of representatives who spoke during the consideration of the item.

4. At the 37th meeting, on 13 November, the representative of Austria introduced a draft resolution (A/C.6/40/L.6) sponsored by Argentina, Australia, Austria, Belgium, Brazil, Canada, Cyprus, Egypt, Finland, France, Germany, Federal Republic of, Greece, Hungary, Italy, Jamaica, Japan, Kenya, the Libyan Arab Jamahiriya, the Netherlands, Nigeria, the Philip-

pires, Romania, Senegal, Singapore, Spain, Sweden, Turkey, and Yugoslavia, later joined by Czechoslovakia, Guyana and Morocco as well as a draft resolution (A/C.6/40/L.7) sponsored by Argentina, Australia, Austria, Brazil, Canada, Cyprus, Egypt, Finland, France, Germany, Federal Republic of, Greece, Hungary, Italy, Jamaica, Japan, Kenya, the Netherlands, Nigeria, the Philippines, Senegal, Singapore, Spain, Sweden, and the United States of America, later joined by Czechoslovakia and Guyana.

5. At its 38th meeting, the Committee adopted by consensus draft resolution A/C.6/40/L.6 (see para. 6, draft resolution I) and draft resolution A/C.6/40/L.7 (see para. 6, draft resolution II).

Recommendations of the Sixth Committee

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

[Texts not reproduced in this section. Draft resolution I and draft resolution II were adopted, with editorial changes, as General Assembly resolutions 40/71 and 40/72. See section D, below.]

¹Official Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17). The report was submitted 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, A/7408, para. 3) (Yearbook . . . 1968-1970, part two, 1, B, 2).

D. General Assembly resolutions 40/71 and 40/72 of 11 December 1985

40/71. 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 eighteenth session,¹

Recalling that the object of the Commission is the promotion of the progressive harmonization and unification of international trade law,

Recalling, in this regard, its resolution 2205 (XXI) of 17 December 1966, as well as all its other resolutions relating to the work of the Commission,

Recalling also its resolutions 3201 (S-VI) and 3202 (S-VI) of 1 May 1974, 3281 (XXIX) of 12 December 1974 and 3362 (S-VIII) 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 co-operation among all States on a basis of equality, equity and common interest 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 and unifying international trade law,

Stressing the value of participation by States at all levels of economic development, including developing countries, in the process of harmonizing and unifying international trade law,

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

2. *Commends the Commission for the progress made in its work and for having reached decisions by consensus;*

3. *Calls upon the Commission to continue to take account of the relevant provisions of the resolutions concerning the new international economic order, as adopted by the General Assembly at its sixth and seventh special sessions, and reaffirms the importance, in particular for developing countries, of the work carried out by the Working Group on the New International Economic Order on a legal guide on the drawing up of international contracts for construction of industrial works;*

4. *Notes with particular satisfaction the completion and adoption by the Commission of the Model Law on International Commercial Arbitration;²*

¹Official Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17).

²Ibid., annex I.

I. INTERNATIONAL COMMERCIAL ARBITRATION

A. Analytical compilation of comments by Governments and international organizations on the draft text of a model law on international commercial arbitration: report of the Secretary-General (A/CN.9/263 and Add. 1-3)^a

[A/CN.9/263]

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^aFor consideration by the Commission, see *Report*, chapter II, A (part one, A, above).

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INTRODUCTION

1. The United Nations Commission on International Trade Law, at its fourteenth session, decided to entrust its Working Group on International Contract Practices with the task of preparing a draft model law on international commercial arbitration.¹ The Working Group commenced its work, at its third session, by discussing a series of questions designed to establish the basic features of a draft model law.² At its fourth session,³ it considered draft articles prepared by the secretariat and reviewed, at its fifth and sixth sessions, redrafted and revised articles of a model law.⁴ The Working Group, at its seventh session, considered a composite draft text and, after a drafting group had established corresponding language versions in the six languages of the Commission, adopted the draft text of a model law as annexed to its report.⁵

2. The Commission, at its seventeenth session, requested the Secretary-General to transmit this draft text of a model law on international commercial arbitration to all Governments and interested international organizations for their comments and requested the secretariat to prepare for the eighteenth session of the Commission

an analytical compilation of the comments received.⁶ The present report is submitted pursuant to that request.

3. As at 31 January 1985,⁷ the secretariat had received replies from the following States and international organizations:

States: Argentina, Austria, Burkina Faso,⁸ Chile,⁹ Cyprus, Czechoslovakia, Finland, German Democratic Republic, Germany, Federal Republic of, India, Italy, Japan, Mexico, Norway, Poland, Qatar, Republic of Korea, Sweden, Union of Soviet Socialist Republics,⁹ United States of America and Venezuela;

*International organizations:*¹⁰ Commission of the European Communities (CEC), International Bar Association (IBA),¹¹ International Law Association

¹Report of the United Nations Commission on International Trade Law on the work of its fourteenth session, *Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17)*, para. 70.

²Report of the Working Group on International Contract Practices on the work of its third session (A/CN.9/216).

³See report of the Working Group on International Contract Practices on the work of its fourth session (A/CN.9/232).

⁴See reports of the Working Group on International Contract Practices on the work of its fifth and sixth sessions (A/CN.9/233 and A/CN.9/245).

⁵See report of the Working Group on International Contract Practices on the work of its seventh session (A/CN.9/246).

⁶Any comments received after that date will be presented, in summary form, in a separate document (A/CN.9/263/Add.1).

⁷Burkina Faso, Chile and UNIDO indicated that they had no specific comments to make.

⁸The Government of the Union of Soviet Socialist Republics transmitted comments by Soviet experts. For ease of reference, these will be hereinafter referred to as the comments by the Soviet Union.

⁹It may be noted that ICCA devoted its Interim Meeting (Lausanne, 9-12 May 1984) exclusively to the discussion of the draft text of the Model Law; the reports presented to the Interim Meeting and the report on the proceedings are contained in Pieter Sanders, ed., *UNCITRAL's Project for a Model Law on International Commercial Arbitration*, International Council for Commercial Arbitration, Congress series no. 2, (Deventer, Kluwer 1984).

¹⁰The IBA Section on Business Law, Committee D on Procedures for Settling Disputes, points out that its membership comes from many different countries and it is not possible to formulate a consensus view of the IBA on the Model Law, except that it is clear that the overwhelming majority of its members welcomes the aims of the project and wishes it every success.

(ILA),¹² Secretariat of the United Nations Conference on Trade and Development (UNCTAD) and United Nations Industrial Development Organization (UNIDO).⁸ (In the text below the acronyms are used.)

4. The analytical compilation is structured in the following way: The first part contains general comments, the second part contains specific comments on individual articles and the third part contains comments on some additional points to be considered by the Commission. Any comments which concern the chapter as a whole or article as a whole are presented under the heading "Chapter as a whole" or "Article as a whole". Where a comment refers to a session of the Working Group on International Contract Practices (hereinafter referred to as the Working Group), the compilation indicates the symbol of the respective report.¹³

5. Comments which concern only the drafting or linguistic style of one of the language versions of the Model Law are not reflected in this report. Such comments will be presented to a drafting group which will be convened concurrently with the session of the Commission.

6. In many comments reference is made to the following two international Conventions, which in this compilation are referred to as indicated:

Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 10 June 1958. (United Nations, <i>Treaty Series</i> , vol. 330, p. 38 No. 4739 (1959); UNCITRAL <i>Register of Texts of Conventions and Other Instruments Concerning International Trade Law</i> , vol. II, chap. I)	1958 New York Convention
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European Convention on International Commercial Arbitration, Geneva, 21 April 1961. (United Nations, <i>Treaty Series</i> , vol. 484, p. 364 No. 7041 (1963-1964); UNCITRAL <i>Register of Texts of Conventions and Other Instruments Concerning International Trade Law</i> , vol. II, chap. I)	1961 Geneva Convention
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Analytical compilation of comments

A. General comments on the draft text

1. Appreciation for the work done by the Working Group is expressly stated by the Federal Republic of Germany, Italy, Poland, Venezuela and the United States. All those respondents who make general obser-

vations on the value of the Model Law express support for it (Argentina, Finland, German Democratic Republic, Germany, Federal Republic of, Italy, Japan, Norway, Poland, Qatar, Republic of Korea, Sweden, Soviet Union, United States, Venezuela). The observations of these States and the reasons given for their general approval of the draft text may be summarized as follows:

Form of the Model Law

(a) The Model Law is a notable achievement in the technique of unification of rules on international commercial arbitration (Argentina). It constitutes a sound basis for achieving improved harmonization of international arbitral procedures (Sweden).

(b) There is support for the idea of attaining unification through adoption of a Model Law (Finland, Japan, Norway, Poland, United States), since, as experience shows, a convention would probably not be easily accepted by a great number of States unless it provided for a possibility of important reservations, which would result in diminishing its value as a uniform instrument (Finland). The Model Law is considered to be an appropriate means to promote international commercial arbitration as an instrument for the settling of disputes preferred in international economic relations (German Democratic Republic, suggesting, at the same time, that the Model Law be oriented more directly to the possibility of agreeing to submit cases to the existing permanent arbitral tribunals and to apply their rules of procedure).

(c) The Model Law reflects a realistic approach to the present divergencies among municipal laws and various conventions on arbitration in force (Poland).

(d) The goal of harmonization should be particularly aided by the Model Law, as *lex specialis*, which would prevail over any other municipal law on arbitration (United States).

Usefulness of the Model Law

(a) The Model Law will be of use to many countries (Sweden); it will be of value not only in countries which would benefit from modernization, but also in countries which may be adopting arbitration laws for the first time (United States).

(b) The Model Law is an appropriate means to give assistance in the codification of international commercial arbitration, particularly to those States which do not yet have relevant legal regulations (German Democratic Republic, Germany, Federal Republic of); the Model Law will doubtless be of use to a considerable number of industrialized countries whose legislation is antiquated in this area and has been made obsolete by the practices of modern international commercial arbitration (Federal Republic of Germany).

(c) The Model Law corresponds to the aspirations of the international community and will serve the purpose which had been a guide during the elaboration of the text, namely that the States, in particular developing ones, be able to incorporate it in their legal systems (Venezuela).

¹²ILA considered that in view of the participation of its representative in the Working Group sessions elaborating the text, it was not necessary to submit any additional comments.

¹³The symbols of the reports of the relevant sessions of the Working Group are set forth in footnotes 2-5, above.

Acceptability of substance

(a) The Model Law seems to embody an acceptable regulation of international commercial arbitration (Norway). The present text is in principle acceptable (Republic of Korea). The Model Law, as regards its technique, systematics and content, is considered to be a valuable result of the deliberations of the Working Group (Italy).

(b) Considering that the Model Law is in accord with the 1958 New York Convention and the UNCITRAL Arbitration Rules, it is basically acceptable (Japan).

(c) The Model Law is based on the principle of adequate balance of interests of the parties in all aspects of arbitral procedure (Argentina).

(d) The Model Law is in accordance with modern trends in international commercial arbitration; the policy that most of the provisions be non-mandatory and the principle that court intervention should be avoided as far as possible deserve full support (Finland).

(e) While a degree of compromise is inevitable in a multinational effort, the draft text adopted by the Working Group is considered to be generally reflective of modern arbitration practice and one which should serve to streamline and make more certain the arbitral resolution of international commercial disputes (United States).

Acceptability of underlying principles

(a) The leading underlying principles of the Model Law (i.e. party autonomy, equality, completeness, compatibility of the model law with the 1958 New York Convention, *lex specialis* rule) are a good foundation for international regulation (Poland).

(b) Among the advantages of the Model Law is the use of concepts and forms derived from international legislation which has already been adopted and generally accepted, such as the UNCITRAL Arbitration Rules and the United Nations Convention on Contracts for the International Sale of Goods (Qatar).

(c) All main essentials of the principles of international arbitral procedure propounded by the Model Law are acceptable; it is especially important that the Model Law provides great scope for party autonomy in arbitral proceedings and that it limits control by the courts to a level which appears appropriate for meeting the requirements of speed and security in the proceedings (Sweden).

(d) While certain key policy issues still remain to be resolved by the Commission, the Model Law is generally approved since it provides a comprehensive procedural framework for the arbitral resolution of disputes arising from a broad range of international commercial transactions. It provides for party autonomy in fashioning the arbitration process, reflects principles of fairness and equality of treatment of the parties, includes basic provisions for the functioning of arbitration proceedings where parties have not made necessary provisions, and is faithful to the precepts of the 1958 New York Convention and in general harmony with the

UNCITRAL Arbitration Rules. In international arbitration involving parties of differing nationalities or from different countries with differing legal systems, it is particularly important that parties have freedom to agree to arbitral procedures that best suit their specific needs. The Model Law provides such freedom through consistent application of the principle of party autonomy in fashioning the arbitration process to be used in particular cases. The Model Law also strikes a proper balance in the relationship between arbitration and the courts. The role of the courts in general is one of assistance supportive of the arbitral process and not one of interference with it. Basic considerations of procedural due process, indispensable to any system of justice, are generally well protected by the Model Law. The right of each party to be informed of all claims, evidence and arguments presented against it and to receive an adequate opportunity to present its case are safeguarded (United States).

2. The Soviet Union expresses the view that the draft text of a model law on international commercial arbitration is a good basis for the forthcoming discussion on this matter at the eighteenth session of the Commission. Considering that the content of the draft text will in fact be discussed by the Commission for the first time, it would seem expedient first of all to discuss and determine at the session the principled approach to those problems which are important also for the formulation of specific rules, including problems pertaining to interference of a court with arbitration proceedings, territorial criteria of application of the text to be adopted, and its legal form (model law or convention).

B. Specific comments on individual articles

CHAPTER I. GENERAL PROVISIONS

*Article 1.**Scope of application**Territorial scope of application¹⁴*

1. Finland and Norway support the prevailing view expressed in the Working Group that the place of arbitration should be the exclusive determining factor for the applicability of the Model Law.¹⁵ Finland considers that this approach best corresponds to the practice of most countries. Norway observes that this view is reflected in article 36 (1) (a) (iv), where "the law of the country where the arbitration took place" is referred to. This scope, which should be expressed in a separate paragraph or article of the Model Law, would apply to the bulk of the provisions of the Model Law,

¹⁴Other comments concerning the territorial scope of application of the Model Law or of particular provisions are reflected, in particular, in paras. 2-4 of the compilation of comments on article 34, and also in paras. 2, 5 and 6 of the compilation of comments on article 6, para. 11 of the compilation of comments on article 13, paras. 1 and 3 of the compilation of comments on article 27, and paras. 2-8 of the compilation of comments on chapter VIII of the Model Law ("Recognition and enforcement of awards").

¹⁵A/CN.9/246, para. 167.

in particular to those in chapters III to VII, while some of the provisions of the Model Law are intended to have a broader, in fact global, scope of application (e.g. articles 8, 9, 35 and 36 and, by implication, also articles 1, 2, 4 and 7). Norway emphasizes, however, that the issue of the territorial scope of application of the Model Law needs a further, careful examination which should take into account all the different aspects and related questions.

2. The German Democratic Republic notes that the model law does not give a conclusive answer as to the possibility of the choice of procedural law. It is thought that the Model Law, in conformity with the territorial principle, should not have an escape clause pursuant to which the parties may preclude the law on arbitration existing in the respective territory of the country in favour of the law of another State.

Model law as "lex specialis"

3. The United States suggests expressing in the text the principle of *lex specialis*. This would also help to make clear that there are special aspects of arbitration which are not regulated in the Model Law. Such aspects include, *inter alia*, definitions of arbitrability, the capacity of parties to conclude an arbitration agreement, concepts of sovereign immunity, consolidation of arbitration proceedings, the enforcement of interim measures of protection granted by arbitrators, and the manner in which arbitration awards are enforced. Suitable wording in article 1 (1) to the effect that the Model Law is not a self-contained and self-sufficient system should also serve to clarify the parameters of article 5 dealing with the scope of court intervention.

Model law yields to treaty law

4. The Soviet Union suggests making the wording of paragraph (1) more precise by using, instead of the language "subject to any multilateral or bilateral agreement which has effect in this State" (i.e. in the State that has adopted the model law), the following language: "subject to any international multilateral or bilateral treaty to which this State is a party".

5. In the view of CEC it would be desirable to provide a commentary on paragraph (1) of this article, in particular on the phrase "subject to any multilateral or bilateral agreement which has effect in this State". It appears very important that there be an indication that the adoption of the Model Law by a State that would be a party to the future Convention of Lomé would not modify the provisions on arbitration to be contained in that Convention.

Substantive scope of application: "international commercial arbitration"

6. Norway expresses its assumption that a State in adopting the Model Law is not prevented from extending its scope to cover, in addition to international commercial arbitration, national and non-commercial arbitration. On the basis of this assumption Norway accepts the limitation of the scope of application of the model law to international commercial arbitration.

7. Sweden questions the approach of the Model Law to confine itself to international commercial arbitration. It observes that States, like Sweden, already having well functioning arbitration legislation may hesitate to introduce additional legislation based on the Model Law. Noting the possible view that these States would be free to adopt legislation based on the Model Law applicable also to purely national and non-commercial arbitrations, Sweden points out a risk that such States may choose not to make the Model Law the basis for amendments of their internal legislation or may do so only partly. In such case the striving for harmonization would be negatively affected.

8. Argentina remarks that the wording "this Law applies to international commercial arbitration" should be understood as a criterion which is sufficiently flexible and adequate to the commercial nature of international arbitration.

9. The Soviet Union, noting that under paragraph (2) the Model Law may apply to arbitrations between parties having their places of business in the same State, observes that paragraph (2) might be interpreted as enabling the parties to submit their dispute to arbitration even if under the law of the State where the parties have their places of business the dispute is within the exclusive competence of a judicial, administrative or other authority. Such interpretation would mean, in effect, that the parties could circumvent the rules on arbitrability of disputes. Accordingly, it is proposed to provide in article 1 that the Model Law does not affect the legislation of that State which may declare certain categories of disputes to be within the exclusive competence of a judicial or other authority. It is remarked in this context that article II (1) of the 1958 New York Convention solves the question of arbitrability in a general way and that, although a similar consequence could obtain indirectly on the basis of article 34 (2) (b) (i) of the Model Law, it would be expedient to provide a clear answer to this question in the text of article 1.

10. The United States in a general comment points out that a proper definition of "commercial" and "international" is particularly important since the usefulness of the Model Law will depend on a wording that will ensure, without undue controversy, application of the law to business transactions which, while carried out in a particular country, involve the interests of international trade.

(a) "Arbitration"

11. Poland agrees with the approach that no definition of the term "arbitration" be provided in the Model Law and expresses its understanding that this indicates that the Model Law covers *ad hoc* arbitrations as well as arbitrations administered by a permanent arbitral institution regardless of the degree of "institutionalization".

(b) "Commercial"

12. Mexico and UNCTAD suggest restricting the scope of the term "commercial". UNCTAD notes that

the term "commercial" could be interpreted to mean that one could submit to arbitration matters which fall within the competence of Governments and involve public law issues and hence should not be submitted to arbitration. It is observed that the statement in the text of the footnote that the term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature could lead a party to believe, for example, that there could be arbitration concerning practices which may be forbidden under the law of one of the parties. Mexico makes specific comments on how to restrict the scope of the Model Law. It proposes, firstly, to exclude cases of direct foreign investments, which in Mexico are dealt with by specific legislation. Secondly, it remarks that the financial transactions executed by the Mexican Government, whether directly or by way of a guarantee, are considered to form part of the public debt and also should not be submitted to international arbitration. Thirdly, it is observed that in the sphere of the international flow of capital the Mexican law distinguishes transactions of a financial nature which are not subject to international arbitration from transactions of a commercial nature. In making these comments, Mexico remarks that it made similar comments to the thirteenth session of the General Assembly of the Organization of American States in November 1983 which discussed a draft Convention having contents similar to the Model Law and containing a provision identical to the one being commented on here.

13. While Japan does not object to the presentation of the rule of interpretation on "commercial" in the footnote to article 1 or to the suggestion contained in the rule that the term be given a wide interpretation, it is of the opinion that the term "commercial" would not be necessary when a State incorporates the model law in its domestic law. In such case it would suffice to provide a clarification to the effect that the law deals with disputes of a private nature.

14. The Federal Republic of Germany and the United States comment on the need to make clear in the Model Law that it applies irrespective of whether the parties are commercial persons. The Federal Republic of Germany, noting that such clarification was contained in a previous draft and deleted by the Working Group,¹⁶ proposes reinstating the clarification and suggests the following text with a somewhat shorter list of examples of commercial transactions than are contained in the present text:

"An arbitration is commercial if the matter of arbitration is in the widest sense of a commercial nature, irrespective of whether the parties are 'commercial persons' (merchants) under any given national law, e.g. any transaction for the supply or exchange of goods, factoring, leasing, construction of works, financing, banking, insurance, carriage of goods or passengers . . . etc."

The proposal of the United States is to add the words "regardless of the nature or character of the parties" at the end of the first sentence of the present text.

¹⁶A/CN.9/245, para. 163.

15. Some respondents propose additions to the rule of interpretation on "commercial" to make it wider or clearer. Czechoslovakia proposes to add "inspection contracts to verify the quality or quantity of goods". The German Democratic Republic proposes to add a reference to typical cases related to the law of the sea in addition to carriage of goods by sea and, with respect to the clarity of the definition, raises the question whether the present text indicates clearly enough that a commercial relationship may be of a contractual or non-contractual nature. The United States proposes the addition of the words "or services" after the word "goods" in the second sentence of the footnote.

16. Sweden states that the interpretation of the term "commercial" may raise problems and that this term, if it is to be retained at all, should be interpreted as broadly as possible.

17. The Federal Republic of Germany, Poland, Sweden and the United States observe that the rule of interpretation on "commercial" may not be understood in a certain and uniform way, particularly in view of the fact that it is contained in a footnote which is likely to be given different weight and effect in the various legal systems. For this reason, the Federal Republic of Germany, Sweden and the United States suggest the inclusion of the text of the footnote into the body of the text of the Model Law. In support of this suggestion the United States notes past difficulties stemming from the rather narrow meaning given to the term "commercial" in some countries and the resulting importance of providing guidance with regard to its interpretation.

(c) "International"

Width and certainty of the test of internationality

18. India, Norway, Poland, United States and IBA express the view that the objective should be to achieve more clarity and certainty in delimiting the notion of "international". The United States and IBA point out that it is important that the parties should know from the beginning whether an arbitration will be governed by the Model Law or by some other regulations if the State has such other regulations on domestic arbitration. The United States and IBA suggest reconsidering the proposal discussed at the fifth, sixth and seventh sessions of the Working Group, according to which the present concept should be coupled with the agreement of the parties to define the arbitration as international.¹⁷ The United States draws attention to the many forms in which international commerce is conducted. One form, for example, is when a corporation which is doing business in another country opens an office in the foreign country. As a business matter, it is suggested, the transaction is international regardless of whether the office is in the form of a branch or an entity organized under local law. It is believed that in such a situation contracts made by an office formed as a corporation would come within the definition of subparagraph (c) because those contracts are related to

¹⁷A/CN.9/233, para. 60; A/CN.9/245, para. 166; A/CN.9/246, para. 162.

more than one State. However, to remove any doubt or later argument concerning this point, the United States proposes the addition to subparagraph (c) of a new sentence which would provide that, if the parties to an arbitration agreement have written into their contract a statement that it involves interests in more than one State, they shall thereafter be precluded from denying that it does. Parties would not need to add such a statement to their contract to have the contract be within subparagraph (c), but if they did include such a statement a party could not later contend that the contract was not "international" within the meaning of the model law.

19. Japan states that the definition of the term "international" is acceptable.

20. Under the assumption that there may exist a national regulation, different from the Model Law, for national or non-commercial arbitration, Norway suggests that the Model Law ought not to preclude the parties from agreeing that the arbitration will be in accordance with such regulation even if their relationship is international and commercial. Furthermore, as the criteria for defining an arbitration as international and commercial are vague, the parties to the arbitration agreement may wish to make provision for the choice of law on arbitration in the arbitration agreement. Norway therefore suggests including a new provision in article 1 enabling the parties, subject to the territorial scope of application of the Model Law, to stipulate whether the Model Law or another law applies.

Parties' places of business in different States (article 1, paragraph 2 (a))

21. Sweden states that the interpretation of the term "international" may raise problems and that this term, if it is to be retained at all, should be interpreted as broadly as possible. Thus, a dispute should be considered international even when it has arisen in an operation conducted between parties having their places of business in one State if one party is a subsidiary company of a foreign company, and that according to the present wording of paragraph (2) (a) and (b) such dispute would not be considered international. It is proposed to delete paragraph (3) and modify paragraph (2) (a) so that, for an arbitration to be considered international, it would suffice that the parties have their principal places of business in different States.

Places, other than place of business, determining international character of arbitration (article 1, paragraph 2 (b))

22. Czechoslovakia suggests deleting the text of paragraph (2) (b) in order to avoid submitting disputes between parties from one State to an international arbitration.

23. The Federal Republic of Germany, noting that the Working Group at its last session decided to include in paragraph (2) (b) (i) the words "or pursuant to",¹⁶

raises the question whether these words are directly related to the possibility envisaged under article 20 (1) that the place of arbitration, failing agreement by the parties, is to be determined by the arbitral tribunal. If this is so, the arbitral tribunal would have the option of making international arbitration proceedings out of proceedings that would otherwise have no international connection, solely by determining the place of arbitration. In the view of the Federal Republic of Germany this is not intended to be the case; thus, the expression "or pursuant to" should probably be interpreted to mean that, even though the place of arbitration is not expressly defined in the arbitration agreement, the place of arbitration desired by the parties can still be derived from the contents of the agreement.

24. The Federal Republic of Germany observes that "a substantial part of the obligations of the commercial relationship" as referred to in paragraph 2 (b) (ii) need not be connected with the subject-matter of the dispute or even be a subject of the arbitration agreement; the international character of an arbitration should depend solely on the test of the second part of paragraph 2 (b) (ii), i.e. the connection between the subject-matter of the dispute and a place outside the State in which the parties have their places of business. Thus, it is proposed to delete the first part of the sentence in paragraph 2 (b) (ii) given the fact that other provisions of article 1 (2) seem to guarantee that virtually any dispute with any kind of international connection is covered by the Model Law.

Yet other international link (article 1, paragraph 2 (c))

25. The United States is of the view that the provision of paragraph 2 (c) is helpful in achieving a definition that is broad and comprehensive. It is noted that this provision speaks of "subject-matter . . . related to more than one State" and that it might be argued that this means something related to the State itself, i.e. its Government. The United States, suggesting that it should be made clear that the provision also relates to private interests in a State, recommends that it be amended to refer to "subject-matter . . . related to commercial interests in more than one State".

26. Poland is of the opinion that the wording of paragraph (2) (c) is too general and might lead to divergent interpretations. Consequently, it is proposed to replace the provision by a more precise one.

Determination of place of business (article 1, paragraph (3))

27. Cyprus suggests deleting the word "relevant" in paragraph (3). It notes that paragraph (2) (a) defines an arbitration as "international" if the parties to an arbitration agreement have, at the time of the conclusion of that agreement, "their places of business" in different States; therefore, if a party has more than one place of business, the "place of business"—and not the relevant place of business—for the purposes of paragraph (2), is that which has the closest relationship to the arbitration agreement.

¹⁶A/CN.9/246, para. 157.

28. The Federal Republic of Germany suggests deleting the word "habitual" in the second sentence of paragraph (3). In relation to its suggestion (noted in paragraph 14, above) that the Model Law should apply both to businessmen and non-businessmen, it further suggests that, in principle, the place of residence should have the same significance as the place of business. To be precise, it would be necessary to include a reference to the place of residence each time the place of business is referred to in paragraph (2). However, to avoid repetitive references there should be a general provision equalizing both terms; it is remarked that the present formulation of the second sentence of paragraph (3) expressing such equality between the place of business and the place of residence may not be appropriate since it could be understood as referring only to the case covered by the first sentence of paragraph (3), i.e. where a party has more than one place of business or place of residence. The following formulation of paragraph (3) is proposed:

"For the purpose of paragraph (2) of this article, if a party does not have a place of business, reference is to be made to his residence. If a party has more than one place of business or residence, the relevant place of business or residence is that which has the closest relationship to the arbitration agreement."

29. As noted in paragraph 21, above, Sweden proposes the deletion of paragraph (3) in connection with its suggestion for the modification of paragraph (2) (a).

Article 2.

Definitions and rules of interpretation

Article 2, subparagraph (a)

1. Czechoslovakia suggests that the text of this subparagraph should mention that the parties may refer the dispute to a permanent arbitration institution or to an *ad hoc* arbitral tribunal.

Article 2, subparagraph (b)

2. Cyprus expresses the view that the definition of "court" is wider than it should be since it extends to bodies or organs which are not courts or courts of justice. It suggests a definition according to which "court" means a body or organ which is a court according to the law of a country.

Article 2, subparagraph (c)

3. Cyprus states that the meaning of the word "institution" in sub-paragraph (c) is limited and that perhaps the intention of the draftsmen was to include any association of persons.

Article 2, subparagraph (e)

4. Czechoslovakia proposes to add the following text at the end of the first sentence of sub-paragraph (e): "in such a case the mailing by registered letter is sufficient".

5. The German Democratic Republic proposes to make clear that the last-known place of business,

habitual residence or mailing address is the one last-known to the sender.

6. Norway observes that according to subparagraph (e) a written communication would in some cases be deemed to have been received if it has been delivered to the addressee's last-known place of business, habitual residence or mailing address even if the communication has never reached the addressee. While recognizing the need for such a provision, it is also observed that articles 11 (3) (a), 11 (4) (a) and 25 create the possibility of an arbitral award being rendered against a defendant who has not been aware of the proceedings. On the basis of these observations, it is suggested that the defendant be given a right of recourse or appeal which could be exercised in such cases, or that the defendant be allowed to challenge the award on the merits of the case as a defence to an action of recognition or enforcement. In the opinion of Norway, these questions need closer examination.

Proposed additions to article 2

7. Comments containing proposals for additional definitions to be placed in article 2 or elsewhere, are reflected in part C ("Comments on additional points"), paras. 1 to 7.

Article 4.

Waiver of right to object

1. Cyprus states that, as this article is drafted, waiver of the right to object is restricted to non-compliance with a requirement under the arbitration agreement, although it is apparent that the intention was to extend it to failure to derogate from any provision of the law from which a party knows or ought to know that he may derogate.

2. India and Sweden are of the opinion that the waiver rule contained in this article should not be restricted to the non-compliance with non-mandatory provisions of the Model Law. By way of example, Sweden remarks that it does not appear appropriate to allow a party who has taken part in the arbitral proceedings without objecting to a deficiency in the form of the arbitration agreement to raise such objection later when the award is made against him.

3. Sweden, while agreeing with the view adopted by the Working Group that it is desirable to express the non-mandatory character in all provisions of the final text which are intended to be non-mandatory,¹⁹ suggests that it is hardly possible fully to determine in the Model Law such character in respect of each rule. In the view of Sweden there are rules of arbitral procedure from which the parties should not be able to derogate before the commencement or before a certain stage of the arbitral proceedings, or should be able to do so only under special conditions, whereas at a later stage the derogation should be possible. As a consequence, Sweden proposes that, to some extent, the

¹⁹*Ibid.*, paras. 176-177.

question whether a provision of the Model Law is mandatory or non-mandatory should be left to the decision of the arbitral tribunal or a court.

4. Poland supports the restriction of the waiver rule to the non-compliance with non-mandatory rules; however, for reasons of easier application of this rule, it is considered useful to provide a clearer distinction between mandatory and non-mandatory provisions of the Model Law.

5. Finland is of the view that it should be made clear that the rule has effect not only during the arbitration proceedings but also in the post-award stage, i.e. in the setting aside and recognition or enforcement proceedings. Similarly, Japan expresses the view that the effect of a waiver of the right to object (under article 4) should extend to subsequent judicial proceedings.

6. UNCTAD is of the view that the expression "without delay" may give rise to ambiguity or different interpretations as to the time limit for stating an objection.

Article 5.

Scope of court intervention

1. Norway is strongly in favour of the principle that the Model Law itself positively and exhaustively mentions the instances in which the courts may intervene. Furthermore, it is important to limit the possibility of intervention by the courts to a minimum.

2. The Republic of Korea points out that the wording of this article is too narrow in that it does not cover those matters of international commercial arbitration which are not governed by the Model Law. It is proposed to broaden the scope of the article by redrafting it as follows:

"Article 5. Co-operation of the Court

"(1) The Court shall extend co-operation for arbitral proceedings in accordance with the provisions of this Law.

"(2) When the arbitral tribunal is incapable to perform an act which it deems essential to the arbitration, the Court may extend co-operation at the request of the tribunal, in accordance with the provisions of the Civil Procedure Code, *mutatis mutandis*."

Article 6.

Court for certain functions of arbitration assistance and supervision

Comments relating to the jurisdiction of the Court

1. Italy raises the question of how to determine, at least for the cases dealt with in articles 11 (3), 11 (4) and 13 (3), the country whose courts are competent, where the parties have not agreed on a place of arbitration. It proposes to consider a solution like the one contained in article 810 (2) of the Italian Code of Civil Procedure,

which provides for the competence of the court of the place where the arbitration agreement or the contract containing the arbitration clause has been concluded.

2. Poland supports the idea of specifying in article 6 the competence of a State court for certain functions of arbitration assistance and supervision. It is pointed out, however, that article 6 does not settle the competence of State courts in matters not governed by the Model Law; Poland lists as examples of such matters: arbitrability, capacity of parties to conclude an arbitration agreement, jurisdictional immunity of foreign States, competence of an arbitral tribunal to adapt contracts to changed circumstances, fixing of fees for arbitrators or deposits for costs. It is thought that by limiting the scope of article 6 only to matters governed by the Model Law, the advantage of this article is substantially diminished.

3. Qatar considers that article 6 may be construed as conferring an original jurisdiction of first instance to the Court specified in this article and that it could induce parties to select the law of a State they consider advantageous to them by agreeing on the Court of that State even if that State has no connection with the subject-matter of the arbitration. To avoid this undesirable "forum shopping", Qatar proposes the following formulation of the introductory words:

"In the event that the international legal jurisdiction of the courts of this State is established, the court with jurisdiction to perform the functions referred to . . .".

4. Sweden considers that a clarification may be useful as to whether the intention of article 6 is that a single court in each State shall be competent or whether a State can decide, for example, that the competent court shall be the court of the place where either party is domiciled. Another question in need of clarification is whether there is a recourse against the court decision on an application for setting aside an award under article 34.

5. It is proposed to clarify, in respect of all court functions mentioned in article 6 (German Democratic Republic) or in respect of the functions under articles 11, 13 and 14 (Soviet Union), whether the place of arbitration determines the jurisdiction of the Court specified in article 6, or whether it is, for example, the court in the country of the claimant or the country of the respondent. The Soviet Union notes that, in contrast to articles 27 (1) and 34 (1), no specific territorial or other criterion is provided for the jurisdiction of the organ designated in article 6, apart from the very general provision of article 1 on the scope of application of the Model Law; as a result, it is thought probable that a situation will arise where the parties would address, for example for the purpose of appointing an arbitrator, the courts in different States, both of which have adopted the Model Law, and where each of the courts would consider itself competent to make the appointment. Since such possibility of concurrent jurisdiction would create difficulties in the functioning of

international commercial arbitration, it is proposed by the Soviet Union that in providing specific criteria for the competence of the body designated to perform the functions under articles 11, 13 and 14, regard should be had, for example, to the case where the parties agree that the arbitration be conducted under the Model Law or the case where the arbitration is to be conducted in the territory of the State which has adopted the Model Law and the parties have not agreed to submit the arbitration to the law of another State.

6. Czechoslovakia proposes that article 20 should provide that the place of arbitration is decisive for the determination of the court having the jurisdiction to perform the functions of arbitration assistance and supervision and to set aside the award.

Comments relating to the designation of organs entrusted with functions of assistance and supervision

7. Mexico observes that the Court specified in article 6 is one of the courts defined in article 2 (b), and that the Model Law (for example in article 9) makes reference to other courts which may be different from the Court specified in article 6. It is suggested that this difference be made clear in article 6.

8. Japan suggests that the determination of the Court which is to perform the functions of arbitration assistance and supervision should be within the discretion of each State. A national law may provide, for instance, that the Court which performs such functions shall be the Court of the place of arbitration. Furthermore, the various functions enumerated in article 6 do not necessarily have to be performed by the same Court.

9. The Soviet Union raises the question whether it is obligatory to assign in all cases the functions of arbitration assistance and supervision to judicial organs to the exclusion of organs which are not part of the judicial system of the country. It is observed that not in all countries are such functions reserved only to judicial organs and that, from the practical point of view, it seems that a court is not necessarily the most appropriate organ to appoint most efficiently an arbitrator, as compared, for example, with a chamber of commerce that is in a better position in this respect since the matter relates to an international business relation. Although in the case of the challenge of an arbitrator or the termination of the arbitrator's mandate somewhat different considerations may apply, it is suggested that it would not be possible to consider the judicial procedure to be the most appropriate one for these purposes, taking into account particularly that arbitration proceedings are based on the will of the parties. Where a State by law assigns the functions dealt with in articles 11, 13 and 14 to an institution other than the State court, the State would guarantee proper performance of these functions. Accordingly, it is proposed to give the States adopting the Model Law a broader choice in assigning the functions mentioned in article 6, by referring to "the Court or another competent organ" rather than the Court only.

CHAPTER II. ARBITRATION AGREEMENT

Article 7.

Definition and form of arbitration agreement

Article as a whole

1. As to the cases where the parties make use of a permanent arbitral institution which administers arbitrations in accordance with its procedural rules, the Federal Republic of Germany suggests making clear that these procedural rules take precedence over the pertinent provisions of the Model Law unless a rule is in conflict with an imperative provision of the Model Law, in which case this imperative provision would prevail.

2. Norway, raising the question of whether an arbitration agreement is binding upon the estate in case of bankruptcy or a similar status arising from insolvency, presumes that it has not been the intention of the Model Law to deal with this question and that the answer will depend upon the legal system of the place where the bankruptcy or similar proceedings take place.

3. Poland, approving of the provisions of article 7, notes that the Model Law does not deal with the cases where a contract is concluded by an exchange of printed forms containing different arbitration clauses (the so-called "battle of forms"). To avoid uncertainty in these cases, Poland suggests including in the Model Law a provision giving effect to the arbitration clauses proposed by the parties in so far as the clauses coincide. Normally it would follow from both clauses that any dispute should be settled by an arbitral tribunal to the exclusion of State courts. In such cases, it is suggested, the questions not agreed upon by the parties should be governed by the Model Law.

Article 7, paragraph (2)

4. The United States supports the provisions of article 7, particularly the definition that "an agreement is in writing if it is contained in a document signed by the parties or in an exchange of letters, telexes, telegrams or other means of telecommunication which provide a record of the agreement", believing that this definition has the necessary flexibility to take into account the wide variety of ways business in different trades is conducted and the modern means of communication utilized, now and in the future. The United States interprets the phrase "other means of telecommunication" to include all forms of electronic and computer techniques that provide a written record. While it is noted that the wording of the draft text is not identical to the definition in the 1958 New York Convention, it is believed that it is consistent with and expresses the purpose of the Convention.

5. Norway, while observing that paragraph (2) of this article suggests that an arbitration clause in a contract contained in a document signed by only one of the parties will not be recognized as binding, notes that arbitration clauses are frequently found in bills of

lading, which are usually not signed by the shipper. Nevertheless, such clauses are generally considered binding on the shipper and subsequent holders of the bill of lading, although the situation is somewhat more complicated if the bill of lading refers in general to conditions set out in a charter-party (e.g. article 22 (2) of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules)²⁰.) It is suggested that some, but not all, such cases where the signature of one of the parties should suffice will be taken care of by the general provision of article 1 (1) of the Model Law providing that the Model Law applies, subject to any multilateral or bilateral agreement. Nevertheless, Norway proposes to add the following sentence at the end of paragraph (2):

"If a bill of lading or another document, signed by only one of the parties, gives sufficient evidence of a contract, an arbitration clause in the document, or a reference in the document to another document containing an arbitration clause, shall be considered to be an agreement in writing."

6. Argentina is of the view that the last sentence of paragraph (2), according to which a reference to a document containing an arbitration clause should be such as to make that clause part of the contract, should contain a requirement, or at least be interpreted as containing a requirement, that the party against whom the arbitration clause is invoked has or ought to have been aware of the incorporation of the clause in the contract. The objective of this requirement or interpretation would be to protect the party from the application of an arbitration clause which is not usual in a particular trade if that party could not be expected to know the content of the document being referred to.

7. UNCTAD expresses concern that paragraph (2) of this article, by making possible the incorporation of an arbitration clause in a contract by reference to a document containing the clause, could give rise to difficulties in practice.

8. Austria considers that, in paragraph (2), there could be a provision according to which an arbitration clause providing for the dispute to be settled by a court of arbitration of a commodity exchange is also valid if the contract (letter) containing the arbitration clause has not been rejected.

9. The Republic of Korea proposes to redraft the second sentence of paragraph (2) as follows:

"The reference in a contract to a document containing an arbitration clause as a part of the contract constitutes an arbitration agreement provided that the contract is in writing."

Article 8.

Arbitration agreement and substantive claim before court

1. Argentina approves of the principle embodied in article 8 (2) that the court should not intervene in the procedure or substance of the arbitration.

2. Cyprus expresses the view that the issue before the court, as dealt with in paragraph (1), is not "the issue of its jurisdiction", and paragraph (2) ought to be rephrased accordingly.

3. Czechoslovakia suggests adding at the end of paragraph (2) a sentence stating that the arbitral tribunal may make a decision regarding the substance of a dispute only after the decision of the court dealing with the issue of its jurisdiction is final.

4. Italy observes that this article presumes appearance of the defendant before the court and that there is no provision for the case where the defendant has not reacted to the claim before the court. In order to avoid compelling a party to incur expenses necessary for his appearance (where he has to appear in a foreign country) even in the presence of simple dilatory tactics of the claimant, it appears appropriate that, in case of non-appearance, the court may declare on its own motion that it is not competent.

5. Sweden observes that under its law a court in a matter which is the subject of an arbitration agreement does not refer the parties to arbitration, but merely dismisses the case. It is considered desirable to supplement article 8 (1) so as to take that possibility into account as well.

6. The Soviet Union notes the following inconsistency between articles 8 and 16 (3) of the draft text. On the one hand, the court mentioned in article 8 (1) has the power to determine the validity of the arbitration agreement even if the action before that court is brought after the arbitral proceedings have commenced and even if the arbitral tribunal has meanwhile ruled on its jurisdiction since article 8 (2) allows the arbitral tribunal to continue the arbitral proceedings which have already commenced "while the issue of its jurisdiction is pending with the court". On the other hand, according to article 16 (3), a ruling by the arbitral tribunal that it has jurisdiction may be contested by any party only in an action for setting aside. The inconsistency arises where the arbitral tribunal has ruled on its jurisdiction but has not yet made the award, and a party has nevertheless brought an action before a court; in such a case the problem is whether preference should be given to article 8, empowering the court to decide on the arbitral tribunal's jurisdiction, or to article 16 (3), according to which the arbitral tribunal's ruling on its jurisdiction could only be contested in an action for setting aside the award. Moreover, where a party, in spite of the existence of an arbitration agreement, has brought an action to a court before, and not after, the commencement of arbitral proceedings, it may be possible to interpret, *a contrario*, that the party is prevented from addressing the arbitral tribunal while the issue of the validity of the arbitration agreement is pending with the court since article 8 (2) refers only to the continuation of the arbitral proceedings which "have already commenced" before bringing the action to the court. In view of these comments and in view of a need to ensure effectiveness of international commercial arbitration, the Soviet Union proposes to

²⁰A/CONF 99/13, annex I.

replace present paragraph (2) of this article by two new rules. One should provide that bringing an action by a party to a court does not prevent the other party from commencing arbitral proceedings while the issue of the arbitral tribunal's jurisdiction is pending with the court. The other rule should provide that if the arbitral proceedings have already commenced, the court must postpone the settlement of the question of the arbitral tribunal's jurisdiction until the arbitral award is made (reference is made to article VI (3) of the 1961 Geneva Convention). The Soviet Union is of the view that by adopting the above two provisions the last sentence of article 16 (3) might be deleted as unnecessary.

7. The Republic of Korea suggests placing the text of article 8, since it actually deals with commencement or continuation of arbitral proceedings, and of article 9 after article 21, i.e. as articles 21 *bis* and 21 *ter*.

Article 9.

Arbitration agreement and interim measures by court

1. The United States supports the policy of this article and the view expressed by the Working Group, namely that the range of measures covered by article 9 was a wide one and included, in particular, pre-award attachments.²¹ The United States believes that the wide range of interim measures permitted under this article include not only conservation of goods but also, under appropriate circumstances, the protection of trade secrets and proprietary information as being an appropriate subject-matter of interim relief available from a court. This is especially desirable in view of the increasingly complex nature of international commercial transactions giving rise to arbitrable disputes, which presently range from simple trade contracts to the most complicated long-term agreements. It also permits measures to conserve documents or other evidence which may assist the arbitral tribunal in reaching a just decision.

2. The Federal Republic of Germany notes that in the Working Group its delegation advocated mentioning the preservation of evidence as a primary example of an interim measure of protection provided by a State court. Given the fact that the majority in the Working Group did not consider this necessary, it is requested that a pertinent reference be included in the official report.

3. Cyprus favours, in respect of this article and of article 18, the use of the words "interim orders or injunctions" instead of "interim measures of protection".

CHAPTER III. COMPOSITION OF ARBITRAL TRIBUNAL

Chapter as a whole

1. Poland supports the fundamental principle of party autonomy underlying this chapter.

2. The German Democratic Republic is of the view that the periods of time provided in articles 11 and 13 are too short and should be extended.

3. The Federal Republic of Germany proposes to consider the appropriateness of inserting in chapter III a provision on the choice of an individual arbitrator or, in the case of more than one arbitrator, on the composition of the arbitral tribunal, with a view to guaranteeing an impartial decision.

Article 10.

Number of arbitrators

India suggests that, failing agreement by the parties, arbitration should be conducted by a sole arbitrator for the sake of economy and expediency.

Article 11.

Appointment of arbitrators

Article as a whole

1. Finland suggests adding to the provisions on the appointment of arbitrators the following provision:

"If a party fails in his duty to appoint an arbitrator, and the other party prefers to bring the dispute before a court of law rather than insist on arbitration, then the arbitration agreement shall be no bar to the jurisdiction of the court over the dispute."

Finland proposes to further consider whether any other breach of the agreement by a party, for example a failure to pay his share of the advance to the arbitrators, should have the same effect.

Article 11, paragraph (3)

2. Japan, noting that the parties are free to determine the number of arbitrators (article 10 (1)) and that paragraph (3) of this article provides only for the cases where three arbitrators or a sole arbitrator are to be appointed, proposes to deal in a more general way with the appointment of arbitrators when the parties fail to appoint them.

3. Qatar notes that in the Model Law there is no reference to the presidency of the arbitral tribunal if it is composed of three arbitrators and that, although article 29 provides that a presiding arbitrator may be authorized to decide questions of procedure, this provision is not preceded by any definition of the president of the arbitral tribunal or any identification of the arbitrator entrusted with this responsibility. Qatar proposes to provide in article 11 (3) of the Model Law, in the light of article 7 (1) of the UNCITRAL Arbitration Rules, that the arbitral tribunal is to be presided over by the third arbitrator chosen by the other two arbitrators, each of whom is appointed by a party to the dispute.

4. The Soviet Union suggests, for reasons of certainty, replacing in paragraph (3) (a) of this article the words "within thirty days after having been requested to do so

²¹A/CN.9/246, para. 26.

by the other party" by the words "within thirty days of receipt of such request from the other party".

Article 11, paragraph (5)

5. Regarding paragraph (5) providing that the decision of the Court shall be final, Norway has no objection to it as far as it concerns the purely discretionary aspect of the decision. However, the Model Law ought not to preclude a party from challenging the decision on the lower court's procedural handling of the case or the lower court's interpretation and application of the law; since a different solution would be unacceptable, at least to Norwegian law, the question is raised whether the word "final" is meant to preclude even such kind of challenge.

*Article 12.
Grounds for challenge*

1. India is of the view that the grounds for challenge as expressed in this article are too vague to allow easy and uniform interpretation and application.

2. UNCTAD suggests that the last sentence of paragraph (1), providing for the continuous duty of disclosure of certain circumstances, may be inconsistent with the first sentence of paragraph (1), which rightly states that the arbitrator shall disclose any such circumstances on being approached. The duty of disclosure should not continue throughout the proceedings. UNCTAD further suggests that in paragraph (2) it seems appropriate to provide that an arbitrator may be challenged only "if there are reasons to believe that circumstances exist . . ." since such circumstances need to be proved.

3. The United States agrees with the grounds for challenge set forth in article 12. Paragraph (2) properly establishes the fundamental grounds that an arbitrator may be challenged "if circumstances exist that give rise to justifiable doubts as to his impartiality or independence". In addition, parties may in their contracts agree that arbitrators must have certain professional or trade qualifications and that they are subject to challenge if they do not possess those qualifications. In order to ensure that the Model Law respects this aspect of party autonomy, the United States suggests adding the words "or on such additional grounds as the parties may agree" to the first sentence of article 12 (2).

*Article 13.
Challenge procedure*

Article 13, paragraph (1)

1. As to the proposal of the United States concerning the words in paragraph (1) "subject to the provisions of paragraph (3) of this article", see paragraph 8, below.

Article 13, paragraph (2)

2. While the Federal Republic of Germany expresses the view that the challenged arbitrator should not be

involved in deciding on the challenge, Japan is of the view that it is desirable to state in paragraph (2) that the arbitral tribunal, which has the power to decide on the challenge, includes the challenged arbitrator. UNCTAD notes that this rule could only apply if there were three or more arbitrators.

3. The German Democratic Republic proposes to add to paragraph (2) of this article the following provision on the challenge of a sole arbitrator: "If a sole arbitrator is challenged, he may withdraw from his office. Otherwise his mandate will terminate on account of the challenge."

4. Norway is of the view that if a party does not raise an objection in the period of time provided for in paragraph (2), he should be precluded from raising it not only during the arbitral proceedings but also under articles 34 (2) (a) (iv) and 36 (1) (a) (iv) and that this should be clearly expressed either in article 13 or in articles 34 and 36.

5. Sweden observes that under this article the challenged arbitrator appears to have full freedom to withdraw and that as a result of such withdrawal, perhaps at an advanced stage of the proceedings, the party who appointed the arbitrator may be adversely affected by additional costs and delay. One approach to the problem may be to let the arbitral tribunal decide whether a question of challenge shall be decided immediately or whether the decision on the challenge should be left to the court before which the party may contest the award.

6. Norway expresses the opinion that the period of time of 15 days provided in paragraph (2) (and also in paragraph (3)) is too short to give the parties adequate opportunity to challenge an arbitrator. The reason is that, in international arbitration, a communication is often delivered to the addressee's solicitor at the place of arbitration, and this solicitor communicates with the addressee's solicitor at the addressee's place of business, who communicates with the addressee. A reply from the addressee will usually be transmitted in the same way, and at each link some time is needed for processing the communication. Taking into account the usual duration of an arbitration and the provision according to which a challenge does not prevent the arbitral tribunal from continuing the proceedings, Norway considers that it is not necessary to fix such a short period of time.

Article 13, paragraph (3)

7. The Federal Republic of Germany expresses the view that in cases where under article 6 the parties have recourse to the State Court, such recourse is only justified if the parties have not agreed on another procedure which would lead to a conclusive and binding decision, with the exception of the recourse under article 34. Observing that under paragraphs (3) and (4) of article 11 on the appointment of arbitrators, recourse to the Court may be had only where the parties have not agreed on another procedure that

would lead to a conclusive and binding decision, the Federal Republic of Germany suggests that the same reservation be made with respect to the court intervention under article 13 (3). The same suggestion is made in respect of article 14 (see para. 2 of the compilation of comments on article 14).

8. Although paragraph (3) of article 13 contains certain safeguards against the dilatory tactics of a recalcitrant party, the United States is concerned that an interlocutory court challenge during the arbitration proceedings may serve to disrupt and unnecessarily add to the costs of the arbitral process. At the same time it shares the view of arbitration practitioners that the parties should have some ability to challenge an arbitrator and obtain a determination prior to the rendering of an award. It is believed that the best solution is for the parties to agree on a procedure for challenging an arbitrator and that a court challenge during the proceedings should be allowed only if the parties have not agreed on a procedure for challenges. The United States suggests replacing in paragraph (1) the words "subject to the provisions of paragraph (3) of this article" by the words "and the decision reached pursuant to that procedure shall be final".

9. In view of the need to secure an impartial and independent arbitral tribunal and in view of the faculty to continue the arbitral proceedings pending the court decision on the challenge, Norway considers that an appeal against the court decision should not be precluded, at least not in the case where the Court did not agree with the challenge. As to the finality of the decision by the Court, Norway makes the same comment as that on article 11 (5) (see para. 5 of the compilation of comments on article 11).

10. The Soviet Union expresses the view that article 13 (3) admits an exceptionally wide judicial control over arbitral proceedings and that such control seems to be unjustified and is likely to cause considerable delay. The risk of delay is not diminished by the fact that the arbitral tribunal, including the challenged arbitrator, has the possibility to continue the proceedings since this is only a possibility, whereas in practice the arbitral tribunal will most likely refrain from continuing the proceedings until a decision is made by the Court. The Soviet Union proposes to discuss the expediency of deleting paragraph (3) or, at least, limiting it considerably in its scope so that it would apply, for example, to the rare cases where the sole arbitrator or a majority of the arbitrators are challenged, in which case the decision by the arbitral tribunal on the challenge, as provided in paragraph (2), might raise doubts. In other situations, the judicial control concerning the impartiality and independence of arbitrators could, without prejudice to the rights of the parties, appropriately be performed after the termination of the arbitral proceedings.

11. The German Democratic Republic proposes to specify the Court which has jurisdiction under article 13 (3) by adding the words "in the country where the arbitration takes place" between the words "the Court"

and the words "specified in article 6". The same proposal is made in the context of article 14.

Article 14.

Failure or impossibility to act

1. Austria proposes to insert the words "Unless otherwise agreed by the parties" in article 14 to show that the parties are free to agree on the application of a set of arbitration rules which provide a different solution to the situation envisaged in this article.

2. For reasons expressed in paragraph 7 of the compilation of comments on article 13, the Federal Republic of Germany suggests including a reservation in article 14 to the effect that a party would have recourse to the Court only where the parties have not agreed on another procedure that would lead to a conclusive and binding decision.

3. Italy proposes to insert after the words "fails to act" the words "with appropriate speed and efficiency".

4. As to the proposal by the German Democratic Republic to specify the Court which has jurisdiction under article 14, see para. 11 of the compilation of comments on article 13.

5. As to the finality of the decision by the Court, Norway makes the same comment as that on article 11 (5) (see para. 5 of the compilation of comments on article 11).

6. In order to express more clearly the instances of impossibility to act, the Republic of Korea proposes to replace the words "if he withdraws" in the first sentence by the words "if he dies or withdraws".

Article 14 bis

No comments are made on this article.

Article 15.

Appointment of substitute arbitrator

1. Cyprus interprets the words "according to the rules that were applicable" as referring to the procedure laid down in paragraphs (2) and (3) of article 11 and notes that this would be unsatisfactory because these rules provide for the initial appointment of all the arbitrators and not for the appointment of a substitute arbitrator. Its view is that the substitute arbitrator must be appointed by the same procedure by which the arbitrator to be replaced was appointed and that, perhaps, this was the intention of the draftsmen. Cyprus notes that one of the parties may not wish to perform an agreement, reached under article 11 (2) for the initial appointment, when it comes to the appointment of a substitute arbitrator. It suggests that express provision ought to be made for such cases.

2. Norway observes that the intention of the Working Group was to cover in article 15 all cases in which the need for the appointment of a substitute arbitrator may arise,²² and that this intention allows the wording of this article to be simplified by deleting the words "under article 13 or 14 or because of his withdrawal from office for any other reason or because of the revocation of his mandate by agreement of the parties or in any other case of termination of his mandate".

3. Sweden, pointing out its understanding that according to article 14 an arbitrator may withdraw of his own accord without special cause, notes that according to article 15 a substitute arbitrator shall be appointed in the same way as was the arbitrator being replaced. It is observed that, as a consequence, a party may, in consultation with the arbitrator appointed by that party, replace him by another arbitrator; this may enable a party to prolong the proceedings and to replace the arbitrator by one whose views are expected to be more favourable to the party. Sweden therefore suggests that a substitute arbitrator be appointed by an impartial body such as a court; one could also envisage a clause in article 14 which would provide that an arbitrator who withdraws without cause shall be liable to pay the additional costs incurred.

CHAPTER IV. JURISDICTION OF ARBITRAL TRIBUNAL

Article 16.

Competence to rule on own jurisdiction

Article 16, paragraph (1)

1. Cyprus, noting that under its law an arbitration clause which forms part of a contract which is void is itself void, supports the provision in article 16 that a decision by the arbitral tribunal that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause. However, it is suggested that provision ought to be made for the matter to be decided by the court.

2. India suggests adding at the end of the first sentence of paragraph (1) of this article the words "or the identity of any party to the arbitration agreement". This amendment is suggested to cover the problem of accountability of shipowners in the context of open-registry shipping.

Article 16, paragraph (2)

3. The Soviet Union is of the view that the intention of the arbitral tribunal to exceed the scope of its authority would normally only be clear once there is an award covering that matter and that the point of time for raising a plea that the arbitral tribunal is exceeding the scope of its authority should be defined with more precision. The provision would be more precise if the plea had to be raised by a party promptly, as soon as

the matter which is beyond the scope of the arbitral tribunal's authority is raised during the arbitral proceedings (as provided, for example, in article V (1) of the 1961 Geneva Convention).

4. In the view of Sweden, the meaning of the provision on the point of time for raising a plea that arbitrators are exceeding their authority is not entirely clear. The question of the arbitral tribunal's authority may have been discussed during the arbitral proceedings and at that time the arbitral tribunal may have indicated its intention to rule on the controversial issue. However, the arbitral tribunal can hardly be considered bound by such indication. Normally, it is only when the award is made that a party knows with certainty that the scope of the arbitral tribunal's authority has been exceeded. Therefore, the party should be able to raise the plea during the period of time for the application for setting aside the award.

5. Norway expresses the view that a party who fails to raise the plea regarding jurisdiction as required under article 16 (2) should not be allowed to raise this plea in proceedings for setting aside or enforcement. Observing that this view was also expressed in the Working Group,²³ Norway suggests that this should be explicitly provided either in article 16 or in articles 34 and 36.

6. Cyprus proposes the following modification of the first sentence of paragraph (2): "A plea that the tribunal does not have jurisdiction shall be raised not later than the statement of defence; such plea may be raised in the statement of defence."

Article 16, paragraph (3)

7. Austria, India, Norway, Poland and IBA object to the rule contained in the last sentence of paragraph (3) and express the view that a ruling by the arbitral tribunal that it has jurisdiction should be open to immediate court review.

(a) Austria notes that under the present text the parties are, in fact, forced to continue the proceedings, which sometimes causes considerable cost and loss of time before the parties are able to apply for setting aside the award on the ground of lack of jurisdiction of the arbitral tribunal. Therefore, Austria expresses the view that the arbitral tribunal should have the possibility to rule on its jurisdiction as a preliminary question in the form of an award. Such a ruling by the arbitral tribunal could then immediately be contested by any party in an action for setting aside under article 34. Austria observes that under article 13 (3) the party who has not been successful in challenging an arbitrator may immediately request the Court to decide on the challenge and that a similar approach would be more appropriate in the more important case of contested jurisdiction of the arbitral tribunal.

(b) Norway, although agreeing with the prevailing view in the Working Group that there ought not to be a free hand for concurrent court control,²⁴ suggests that

²²*Ibid.*, para. 48.

²³*Ibid.*, para. 51.

²⁴*Ibid.*, para. 55.

in some cases there may be a genuine need for a court decision on the jurisdiction of the arbitral tribunal at an early stage and that the Model Law should allow for some flexibility. Norway proposes to replace paragraph (3) of article 16 by the following provisions:

"(3) The arbitral tribunal may rule on a plea referred to in paragraph (2) of this article either as a preliminary question or in an award on the merits. If the tribunal rules on the plea as a preliminary question, the tribunal may state its ruling in a preliminary award.

"(4) Unless otherwise agreed by the parties, a party may apply to a court for setting aside a preliminary award referred to in paragraph (3) of this article. Such an application shall be made within the time limit referred to in paragraph (3) of article 34.

"(5) Unless otherwise agreed by the parties, the arbitral tribunal decides whether the arbitral proceedings shall continue while the issue of its jurisdiction is pending with the court.

"(6) A ruling by the arbitral tribunal that it has jurisdiction may be contested only in an action referred to in paragraph (4) of this article, in an action for setting aside an award on the merits or as a defence against an action for recognition or enforcement of the award."

(c) Poland is of the view that article 16 (3) is in contradiction to the leading rule of commercial arbitration directed to fast and non-expensive proceedings. It suggests that a plea that the arbitral tribunal does not have jurisdiction should be decided by the State court as soon as possible. For example, one could envisage an obligatory preliminary award of the arbitral tribunal which would be subject to instant contest before the State court.

(d) IBA accepts that the primary authority for the determination of jurisdiction issues, including questions of arbitrability, the validity of the arbitration agreement and so forth, should be the arbitral tribunal itself. However, since the arbitral tribunal's decisions on these matters are ultimately subject to court control, it seems sensible that the intervention of the courts on such issues should be permitted at an early stage, rather than only at the end of the arbitration. This would avoid unnecessary delay and costs. Accordingly, it is suggested that article 16 (3) should be reconsidered, and that article 17, as it was discussed and deleted by the Working Group,²⁵ might be reviewed with a view to reinstating it. It is observed that many practising lawyers feel that concurrent court control should also be available in a more general sense, in addition to the

question of recourse of matters of the jurisdiction of the Court, in order to prevent arbitral tribunals from exceeding their authority, or failing to comply with the requirements of due process. Under the present text of article 16 (3) (as explained in the report of the seventh session of the Working Group²⁶), it seems that there can be no recourse against any interim award or decision of the Court. The policy of limiting court control to the minimum is, of course, well understood (and, it is said, probably accepted by the majority of IBA members), but it is suggested that a policy should not be applied so rigidly as to lead to extreme situations which may result in unnecessary disruption, delay and costs to the parties.

8. Norway and IBA suggest that it should be mentioned in article 16 (3) that a ruling by an arbitral tribunal that it has jurisdiction could also be contested by way of defence against recognition or enforcement of the award. It is pointed out by IBA that under article 16 (3) it appears that questions of jurisdiction may only be raised in an action for setting aside, and not by way of defence to an action for recognition or enforcement of the award. This could lead to an absurd result if the losing party is unable to take an action for setting aside simply because the winner stepped in first with an action for enforcement.

9. Mexico suggests that it should be made clearer that the provisions of paragraph (3) apply not only to the plea that the arbitral tribunal does not have jurisdiction but also to the plea that the arbitral tribunal is exceeding the scope of its authority.

10. The Soviet Union, in the context of its proposal made in respect of article 8 (2) (see para. 6 of the compilation of comments on article 8), is of the view that the last sentence of article 16 (3) might be deleted as unnecessary.

Article 18.

Power of arbitral tribunal to order interim measures

1. Austria proposes to delete this provision. Most of the national legislations relating to perishable goods contain regulations permitting an urgent sale of the goods, and there is no need for rules besides the existing ones. An interim measure ordered by the arbitral tribunal (e.g. to stop the construction of a building) could put the arbitrators in a difficult position and expose them to a claim for damages if the measure proves to be unjustified. Therefore, the power to order interim measures of protection should only lie with the ordinary courts.

2. India is of the view that an arbitral tribunal may be empowered to enforce interim measures of protection.

3. Mexico suggests providing that the security which the arbitral tribunal may require from a party should cover, in addition to the costs for the interim measure

²⁵*Ibid.*, paras. 53-56. The text of article 17, as considered by the Working Group, was as follows:

"Article 17. *Concurrent court control*

"(1) [Notwithstanding the provisions of article 16,] a party may [at any time] request the Court specified in article 6 to decide whether a valid arbitration agreement exists and [if arbitral proceedings have commenced,] whether the arbitral tribunal has jurisdiction [with regard to the dispute referred to it].

"(2) While such issue is pending with the Court, the arbitral tribunal may continue the proceedings [unless the Court orders a stay of the arbitral proceedings]."

²⁶*Ibid.*, para. 56.

of protection which the arbitral tribunal orders, possible damage suffered by the other party if that party wins the case.

4. Norway expresses its understanding that there has been no intention to deal in the Model Law with the question of the limitation of the kind of interim measures which an arbitral tribunal may order or the question of enforcement of the measures or the question of the consequences of non-compliance with the measures.

5. Sweden observes that, under the Swedish legislation, a court may decide on a measure at the request of a party who considers that he has a claim against another person and this applies also if the dispute is to be settled by arbitration and regardless of whether the arbitration proceedings have commenced or not. Sweden notes that article 18, if viewed in the light of article 5, appears to give the arbitral tribunal exclusive authority to order an interim measure of protection. The provision should be clarified so as to show what is really intended. It should also be made clear whether an interim measure ordered by an arbitral tribunal is mandatory or what the consequences are if a party does not comply with the order.

6. Norway proposes to use a different expression for the measures dealt with in this article in order to avoid confusion with the measures ordered by a court as dealt with in article 9.

CHAPTER V. CONDUCT OF ARBITRAL PROCEEDINGS

Article 19.

Determination of rules of procedure

Article as whole

1. In the view of Sweden, it would be of value if the Model Law, in this article or at some other suitable place, induced the arbitral tribunal to a prompt conduct of the arbitration.

Article 19, paragraph (1)

2. In the view of Italy, it would be appropriate to permit the parties to determine the rules of procedure after the arbitrators have accepted their duties, to the extent the arbitrators agree.

3. The United States, noting that article 19 (1) provides that "the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings", raises the related question whether the parties are in any way limited as to the time within which they can agree on such procedure. While the Working Group indicated that "the freedom of the parties to agree on the procedure should be a continuing one throughout the arbitral proceedings",²⁷ the United

States believes that this potentially important question should be clearly answered by the Model Law and proposes the inclusion in paragraph (1) of a statement that the parties may agree on procedure during as well as before the arbitral proceedings.

Article 19, paragraph (2)

4. Italy states that the questions pertaining to the admissibility and relevance of evidence are considered in many legal systems, including the Italian system, to be questions of substantive law and that, as a result, these questions are governed by the rules applicable to the substance of the dispute determined in accordance with article 28.

5. Mexico suggests indicating in paragraph (2) that the power of the arbitral tribunal to conduct the proceedings and to determine the admissibility, relevance, materiality and weight of evidence has to be exercised in a prudent and reasonable way and that the arbitral tribunal always has to give reasons for its decisions.

6. In connection with the provision of article 19 (2) on the conduct of arbitral proceedings, Poland stresses that the arbitral tribunal should keep a proper balance between the interests of the parties and take into account the factors which facilitate the proceedings and enable mutual understanding (for example, the issue of the language of the proceedings).

Article 19, paragraph (3)

7. Norway, observing that according to paragraph (3) each party shall be given a "full" opportunity of presenting his case, notes that the arbitral tribunal's not complying with the provision constitutes a valid ground for setting aside the award (article 34 (2) (a) (iv)) and for refusing recognition and enforcement (article 36 (1) (a) (iv)), and that the provision may also be a basis for delaying tactics. It is therefore proposed to replace in paragraph (3) the word "full" by another word, for example, "adequate".

8. IBA suggests inserting, after the word "full" in paragraph (3), the words "and proper" since, in the English language, the word "full" is rarely used on its own in this sense and the words "full and proper" constitute an idiomatic expression which would be well understood in the context and would be capable of reasonably precise definition. By contrast, the word "full" is relatively imprecise on its own and might be capable of being interpreted in an unduly restrictive sense. It is appreciated that the UNCITRAL Arbitration Rules use the abbreviated version, but this is considered to be less significant in arbitration rules than in national legislations.

Article 20.

Place of arbitration

1. India is of the opinion that the freedom of the parties to agree on the place of arbitration may operate against a weaker party. A possible approach suggested

²⁷*Ibid.*, para 63.

is to hold the arbitration in the respondent's country. India is, however, not opposed to the inclusion of the test of objectivity as envisaged by the phrase "the place of arbitration shall be determined by the arbitral tribunal" in article 20 (1).

2. In the understanding of Norway, there need not be a genuine link between the place of arbitration as determined under paragraph (1) and any other places where, under paragraph (2), parts of the arbitral proceedings, including the making of the award, take place. Recalling the prevailing view expressed in the Working Group, namely that the exclusive determining factor for the applicability of the Model Law should be the place of arbitration,²⁸ and recalling the provisions of article 31 (3) according to which the award shall be deemed to have been made at the place as determined in accordance with article 20 (1), Norway observes that the place of arbitration is, or ought to be, a decisive factor under articles 6, 27, 28 (2), 34 and 36 (1) (i), (iv) and (v). It proposes to make clear whether such "constructive" place of arbitration as determined in accordance with article 20 shall be pertinent in relation to every provision of the Model Law where the place of arbitration is referred to or is otherwise relevant. Appreciating the intention of paragraph (2) of this article, Norway proposes to insert a provision in the Model Law to the effect that a "constructive" place of arbitration shall not be relevant in respect of all, or some of, the provisions where the place of arbitration is the determining factor, if there is no genuine factual link between that place and the actual arbitral proceedings.

3. As to the proposal by Czechoslovakia to deal in article 20 with the issue of jurisdiction, see para. 6 of the compilation of comments on article 6.

Article 21.

Commencement of arbitral proceedings

1. Czechoslovakia suggests adding at the end of this article the following text: "In case of delivery of the request by mail the arbitral proceedings commence on the date of the post-stamp of the dispatching post office."

2. Observing that the date of commencement of arbitral proceedings has great significance for the limitation or extinction of a claim, Czechoslovakia suggests adding the following provision after article 21:

"(1) A request for the dispute to be referred to arbitration filed with arbitrators or with a permanent arbitral institution has the same legal effects as if a request in this matter were filed with a court.

"(2) Where the arbitral tribunal rules that it has no jurisdiction or where the award is set aside, and the party thereon files a new request with a court within thirty days following the receipt of the ruling rejecting the jurisdiction or the receipt of the judge-

ment setting aside the award, neither limitation nor extinction of his claim by lapse of time may be pleaded against him."

3. Japan notes that under its law, and presumably also under the law of other countries, in the case of arbitration administered by a permanent arbitral institution a prescription period ceases to run at the time when a request for arbitration is submitted to such institution. Accordingly, Japan proposes the following addition to this article:

"In the case of arbitration administered by an arbitral institution, the arbitral proceedings commence on the date on which a request for arbitration is received by the arbitral institution."

Article 22.

Language

1. In the opinion of Austria, the detailed provision in the last sentence of paragraph (1) is unnecessary and should be deleted.

2. The Federal Republic of Germany is of the view that where the parties have not agreed on the language to be used in the arbitral proceedings there is a need to prevent an arbitrary determination of the language. This should be achieved by providing that, failing agreement by the parties, the language or languages to be used in the proceedings should be determined by the arbitral tribunal in accordance with the principle of article 19 (3), i.e. that each party shall be given a full opportunity of presenting his case.

Article 23.

Statements of claim and defence

Article 23, paragraph (1)

1. Italy expresses the view that it might be more appropriate to set in the Model Law itself a period of time for stating the claim and defence instead of leaving its determination to the parties or the arbitral tribunal.

2. The United States proposes, consistent with the concept of party autonomy, to make clear by appropriate wording that the provision of paragraph (1) is not mandatory. Uncertainty on this point in the Model Law could lead to difficulties for parties who regularly utilize arbitration rules or contract provisions which are not entirely consistent with this provision of the draft text.

Article 23, paragraph (2)

3. Cyprus is of the view that the phrase "any other circumstances" is too wide and uncertain. The practice with regard to amendments of pleadings has always been to give leave to amend, unless the court is satisfied that the party applying was acting *mala fide* or that, by his blunder, he had done some injury to his opponent which could not be compensated for by costs or otherwise. However negligent or careless the first

²⁸*Ibid.*, para. 167.

omission may have been, and however late the proposed amendment, the amendment should be allowed if it can be made without injustice to the other side. There is no injustice if the other side can be compensated by costs. An amendment ought to be allowed if thereby "the real substantial question can be raised between the parties".

4. The Soviet Union considers that paragraph (2), envisaging that an amendment of or supplement to a claim or defence may not be allowed by the arbitral tribunal, depending on "the delay in making it or prejudice to the other party or any other circumstances", gives to the arbitral tribunal excessively broad freedom of discretion in the matter which is important for a comprehensive consideration and fair settlement of the dispute. Such freedom derives, in particular, from the phrase "other circumstances", and that phrase should be deleted. Moreover, the reference to "prejudice to the other party" is considered equivocal. It is logical to suppose that practically any amendment or supplement introduced by a party works to its benefit and, consequently, for "prejudice" of the other party. It appears that it would be more fair to provide for a right of a party to introduce amendments and supplements at any time before the arbitral tribunal announces the termination of the examination of the case or, at least, to restrict the discretion of the arbitral tribunal, for example, by referring only to the character of and reasons for the delay.

Article 24.

Hearings and written proceedings

Article 24, paragraphs (1) and (2)

1. Poland and the United States propose that paragraphs (1) and (2) of article 24 should be replaced by a single paragraph, based largely on article 15 (2) of the UNCITRAL Arbitration Rules, as follows:

"Unless the parties have agreed that no hearings shall be held, if either party so requests at any appropriate stage of the proceedings, the arbitral tribunal shall hold hearings for the presentation of evidence by witnesses or for oral argument. In the absence of such a request, the arbitral tribunal shall decide whether to hold such hearings or whether the proceedings shall be conducted on the basis of documents and other materials."

In connection with this proposal, Poland notes that the parties usually do not stipulate in the arbitration agreement that there must be a hearing, and that, where any negotiations on this point have not produced an agreement, the Model Law gives all powers to the arbitral tribunal; this solution is undesirable and is in conflict with the interest of the parties for whom the hearing constitutes a key element of the proceedings where they are able to put forward their full argumentation. The United States, concerned that under the present text of article 24 a party desirous of a hearing is not assured that there will be one, advances the following arguments in support of the proposed text.

The right to a hearing, unless waived, is an important means of ensuring a just result. Unless the right is expressly waived, a party should have the right to introduce oral evidence by witnesses and to have the tribunal determine the credibility of any witness. A party also should have the right to communicate its legal and factual arguments as effectively as possible. This can often be done best by oral argument. The corresponding provision of the UNCITRAL Arbitration Rules, article 15 (2), provides that "If either party so requests at any stage of the proceedings, the arbitral tribunal shall hold hearings . . ." There seems to be no reason to depart from this principle already adopted by the Commission. Inclusion of this principle in the Model Law would also eliminate a possible ground for the setting aside of an award on the theory that a party had been "otherwise unable to present his case" within the meaning of articles 34 and 36. The United States considers that the danger of possible abuse of the right to be heard as a delaying tactic should be avoided by application of the words "at any appropriate stage of the proceedings" already contained in the present draft of paragraph (2). Experience has shown that article 15 (2) of the UNCITRAL Arbitration Rules, on which the proposed text is modelled, is effective and unambiguous. Furthermore, consistency between the Model Law and the UNCITRAL Arbitration Rules on the subject of hearings will promote uniformity in international arbitration procedure.

2. The German Democratic Republic suggests formulating the principle laid down in article 24 (2) in clearer and more compelling terms, i.e. that oral hearings shall be held whenever so requested by a party (article 24 (2)) or whenever there is doubt about the attitude of the parties in respect of holding an oral hearing.

3. Sweden suggests that in paragraph (2) the word "may" should be replaced by the word "shall".

4. IBA proposes to reconsider the wording of article 24 (2). The present text suggests that the question of whether or not a hearing should be held is entirely within the discretion of the tribunal, even if a hearing has been requested by one of the parties. Such a result appears, *prima facie*, to be contrary to the prevailing view in the Working Group, namely that "the right of a party to request a hearing was of such importance that the parties should not be allowed to exclude it by agreement".²⁹ The report of the Working Group highlights the divergence of view but does not appear to resolve it.³⁰

5. The Soviet Union suggests providing in paragraph (2), for the sake of certainty, that in all cases or at least in the case where the parties have failed to agree, after the dispute has arisen, on proceedings on the basis of documents only, the arbitral tribunal must, at the request of either party, hold oral hearings after having notified the parties about the hearing.

²⁹*Ibid.*, para. 77.

³⁰*Ibid.*, para. 78.

6. In the view of Norway, paragraph (1) seems to imply that the arbitral tribunal cannot decide that the proceedings shall be conducted partly on the basis of oral hearings and partly on the basis of documents. It is thought that the arbitral tribunal should have this opportunity and, consequently, it is suggested to modify paragraph (1) as follows:

"(1) Subject to any contrary agreement by the parties, the arbitral tribunal decides whether or to what extent to hold oral hearings and whether or to what extent the proceedings shall be conducted on the basis of documents and other materials."

7. Austria favours replacement of the opening phrase of paragraph (1) "subject to any contrary agreement by the parties" by the phrase "unless otherwise agreed by the parties", as the latter is frequently used in the Model Law.

Article 24, paragraph (3)

8. In the view of Cyprus, the Model Law should determine the period of time between the notice and the hearing or meeting since the word "sufficient" will give rise to problems.

9. The Soviet Union suggests, for the reasons of clarity, replacing the words "for inspection purposes" in paragraph (3) by the words "for the purposes of inspection, indicated in article 20 (2)" or by the words "for the purposes of inspection of goods, other property, or documents".

Article 24, paragraph (4)

10. The Soviet Union considers the requirement in the second sentence of paragraph (4), that any "other document" on which the arbitral tribunal may rely in making its decision must be communicated to the parties, as too broad since it can be interpreted to apply, for example, to documents such as publications of laws, judicial precedents and legal studies. The requirement should refer only to documents of evidentiary nature, i.e. "documentary evidence" in the sense of article 22 (2), and this should be clearly stated in paragraph (4) of article 24.

Article 25. Default of a party

Article 25, subparagraph (b)

1. The Federal Republic of Germany expresses the view that subparagraph (b) could be interpreted to mean that silence on the part of the respondent would not result in any disadvantage to him, and that this is not the intended meaning. The provision is meaningful only to the extent that the claim made by the claimant is not recognized as such. On the other hand, the arbitral tribunal should be able to come to this or a similar conclusion in individual cases. In other words, it should be left to the arbitral tribunal to draw those conclusions from the silence of the respondent that appear most probable.

Article 25, subparagraph (c)

2. Italy expresses the opinion that it might be appropriate to provide a sanction for the case of the default of a party dealt with in subparagraph (c); a minimum sanction could be that the failure to appear at a hearing or to produce documentary evidence is an element which the arbitral tribunal could take into account in deciding the case.

3. In the view of the Soviet Union, subparagraph (c), according to which the arbitral tribunal "may" continue the proceedings, also empowers the arbitral tribunal not to continue the proceedings; it would be more appropriate to provide that the arbitral tribunal "may, and at the request of the other party must, continue the proceedings".

Article 26. Expert appointed by arbitral tribunal

Article 26, paragraph (1)

1. Mexico notes that article 26 (1) (b) empowers the arbitral tribunal to require "one of the parties" to give information to the expert. Mexico suggests making clear that each of the parties, and not only one of them, could be so required. (Note by the secretariat: in article 26 (1) (b), the English words "may require a party" were translated in the Spanish language as "podrá solicitar a una de las partes".)

2. The Soviet Union is of the opinion that the freedom of the parties to restrict the right of the arbitral tribunal to appoint an expert should be limited to the time before the appointment of the arbitrators, with the consequence that the arbitrators would know of the restriction when accepting their appointment.

Article 26, paragraph (2)

3. Cyprus suggests that paragraph (2) should provide for a right of the arbitral tribunal to put questions to the expert regardless of any agreement to the contrary between the parties.

Article 27. Court assistance in taking evidence

Comments relating to territorial scope of application of article 27

1. Austria, Japan and the Soviet Union are of the view that the scope of article 27 should be limited to arbitral proceedings "held in this State" and that, therefore, the words "under this Law" should be deleted. Austria emphasizes that this limitation would be in conformity with the approach that the place of arbitration should be the exclusive determining factor for the application of the Model Law.

2. Japan expresses its support for the decision of the Working Group that this article should deal only with court assistance to arbitrations taking place in the State

of the court giving assistance,³¹ but stresses that this should not mean denial of assistance in obtaining evidence pursuant to the rules of international judicial assistance or co-operation.

3. The United States notes that article 27 (1) reflects the decision of the Working Group to limit article 27 to obtaining evidence within the State in which the arbitration takes place and not to extend it internationally, and that it was the understanding of the Working Group that this decision was subject to later review in the context of the general deliberation on the territorial scope of application of the Model Law.³² It is believed that it would serve the effectiveness of international commercial arbitration to include in the Model Law, as an addition to article 27, provisions which would empower courts in the State in which the arbitration is held (a) to transmit to a court in a foreign State a request for assistance in obtaining evidence for use in arbitration (United States, also Norway), and (b) to respond to any such request transmitted by a foreign court in the same manner as if the request had been made by the foreign court itself for assistance in obtaining evidence for use in a court proceeding (United States).

Article 27, paragraph (1)

4. Austria suggests that the Model Law should provide that the arbitral tribunal's approval of the party's request for court assistance should be given in writing. Austria further suggests that the provisions of paragraph 1 (a), (b) and (c) on the contents of a request for court assistance are not necessary and should be deleted.

5. The Soviet Union considers that it is hardly appropriate to have a rule on court assistance as regards the taking of evidence not only from a witness, but also from an expert witness, since the participation in the arbitration proceedings of expert witnesses is ensured by the party concerned (article 26 (2)).

Proposed addition to article 27

6. Sweden suggests that differences among legal systems in procedures for court assistance in obtaining evidence, and the difficulties arising therefrom, may warrant the inclusion of a provision for the cases where evidence is possessed by a party; under such provision, the arbitral tribunal, in addition to the possibilities laid down in article 27, should have the power to order the party who is in possession of evidence to produce it, and, in the event of refusal to comply with such order, the arbitral tribunal should be expressly empowered to interpret the refusal to that party's disadvantage.

CHAPTER VI. MAKING OF AWARD AND TERMINATION OF PROCEEDINGS

Chapter as a whole

Poland expresses support for the provisions of this chapter since they are drafted in a progressive and

flexible way, reflecting the present tendencies in international commercial arbitration. Poland notes as special example thereof article 28 (1) on the choice of the substantive law.

Article 28.

Rules applicable to substance of dispute

Article as a whole

1. The Republic of Korea considers remarkable that the Model Law refers to such a critical question as the conflict of laws rules applicable to the substance of international commercial disputes.

2. Sweden suggests that the rules on the choice of law reflect a rather traditional view of the question. If the rules are adopted in their present form, there is a risk that the trend towards a free judgement of the question of choice of law that has been noticeable in international arbitration practice will be adversely affected. Such a consequence would be regrettable.

Article 28, paragraph (1)

3. The Federal Republic of Germany and the United States express their support for paragraph (1) of article 28 on the understanding, also expressed by the Working Group,³³ that it provides parties with a wider range of options and that it would, for example, allow them to designate as applicable to their case rules of more than one legal system, including rules of law which have been elaborated on the international level. The Federal Republic of Germany notes that this would provide the parties with more room for manoeuvre as regards the extent to which they desire a decision in accordance with the rules of law or a decision *ex aequo et bono*. While, in general, decisions in accordance with the rules of law are desired in arbitral proceedings as well, businessmen often want a decision not according to the letter of the law, but a decision based on practical economic factors. The term "rules of law" must be interpreted in a broad sense so as to allow deviating from the provisions of law in accordance with the declared or presumed will of the parties.

4. It is the understanding of Argentina that the rules of law chosen by the parties do not necessarily have to be the rules of a national law but can be, in a hierarchical order, the rules set forth in the contract, the trade usages and the rules of an international convention such as the 1980 United Nations Convention on Contracts for the International Sale of Goods. It is observed that in the case of such choice of rules of law, the parties are not prevented from designating a national law to govern, in a subsidiary way, the questions not resolved by the rules of law chosen by the parties. Argentina points out that in making any of these choices account should be taken of the rules of exclusive application of the law of the State where the arbitration takes place or of other States where the award may have to be recognized or enforced, or of the rules of public policy which the parties may not exclude by agreement.

³¹*Ibid.*, para. 96.

³²*Ibid.*, para. 97.

³³A/CN.9/245, para. 94.

5. The Soviet Union proposes to replace in paragraph (1) the words "rules of law" by the word "law", since the term "rules of law" introduces a new and ambiguous notion that may cause considerable difficulties in practice. The traditional notion of "law" should be retained in the present rules designed for universal application, in spite of the views, mainly doctrinal ones, that the arbitrators may use not only the law of a State but also extra-national or non-national principles and rules. In this connection reference is made to the following rules which reflect the traditional approach: article VII of the 1961 Geneva Convention, article 33 of the UNCITRAL Arbitration Rules and article VII of the 1966 Rules for International Commercial Arbitration and Standards for Conciliation of the United Nations Economic Commission for Asia and the Far East.

6. Cyprus states that, perhaps, the word "law" (not "rules of law") is the appropriate word.

Article 28, paragraph (2)

7. Italy proposes to redraft present paragraph (2) as follows:

"Failing any designation by the parties, the arbitral tribunal shall apply the rules of law which it considers appropriate, taking into account the provisions contained in existing international conventions or uniform laws, whether already in force or not, and, in the absence of such conventions or uniform laws, the laws of the State where the parties have their place of business."

8. The Federal Republic of Germany and Norway express the view that paragraph (2) allows too much discretion to the arbitral tribunal in finding the applicable conflict of laws rules. The Federal Republic of Germany points out that such a broad rule may, on the one hand, put an arbitral tribunal in a difficult position when determining the appropriate conflicts rule and, on the other hand, give rise to additional controversy, protracting the proceedings.

9. Consequently, the Federal Republic of Germany proposes that, failing agreement of the parties on the applicable rules of law, the applicable law should be determined in accordance with the conflict of laws rules of the place of arbitration, provided that the place has been agreed upon by the parties; it is thought that, if the place of arbitration has been determined by the arbitral tribunal, the conflict of laws rules of that place would not be appropriate because the arbitral tribunal may be guided in deciding on that place by considerations unrelated to the case at issue. If the parties have not agreed upon a place of arbitration, it is proposed to rely on the conflict of laws rules most closely connected with the subject-matter of the dispute.

10. Norway puts forth two variants of paragraph (2) for consideration. The first one is the following:

"(2) Failing any designation by the parties and provided that they have agreed on a place of arbitration, the arbitral tribunal shall apply the law

determined by the rules of conflict of laws established in the jurisdiction where that place is situated. If the parties have not agreed on the place of arbitration, but have their relevant places of business within the territory of the same legal system, the arbitral tribunal shall apply the law determined by the conflict rules of that system. Otherwise, the tribunal shall apply the law of the jurisdiction [to which the dispute is most closely related] [with which the dispute is most properly connected]."

With respect to the first variant, it is said that the present paragraph (2) seems to give the arbitral tribunal too wide a discretion in applying conflict of laws rules and thereby, by implication, in deciding on the applicable law. If the parties have agreed on a place of arbitration, they will often expect the conflicts rules of that place to be applicable; if, however, the parties have not agreed on such place but happen to have their relevant places of business in the same State, they will often expect the conflicts rules of that State to apply even if the arbitral tribunal decides to conduct the proceedings in another State. However, since Norway is not convinced that the indirect approach of the suggested paragraph (2) to the choice of law question is the most suitable one, and since the Model Law probably ought to address the question directly and also provide some criteria for the choice, the following wording is proposed as a second variant:

"(2) Failing any designation by the parties, the arbitral tribunal shall apply the law of the jurisdiction with which the dispute is most [closely related] [properly connected]. If the dispute is not most [closely related to] [properly connected with] any particular jurisdiction, the tribunal shall apply the law determined by the rules of conflict of laws in the jurisdiction where the arbitration takes place as determined in article 20 paragraph (1)."

Article 28, paragraph (3)

11. Italy proposes to add to the text of paragraph (3) the following provision:

"Notwithstanding such an authorization, the arbitral tribunal, in taking its decision, shall, to the largest possible extent, ensure the enforceability of the award within the States with which the dispute has a significant connection."

Proposed addition to article 28

12. The United States, recalling the decision of the Working Group to delete from article 28 the requirement that the arbitral tribunal decide in accordance with the terms of the contract and take into account the usages of the trade applicable to the transaction,³⁴ advocates the restoration of such requirement. Reference by the arbitral tribunal to contract terms as well as trade usages is required by article 33 (3) of the UNCITRAL Arbitration Rules, which were unanimously recommended by the General Assembly in its resolution 31/98 of 15 December 1976 as being acceptable in countries with different legal,

³⁴*Ibid.*, par. 98-99.

social and economic systems; in recommending these Rules, the member States of the United Nations approved the important policy of recognizing the applicability of contract terms and trade usages when deciding particular disputes. It is noted that a provision such as the one proposed is also contained in article VII of the 1961 Geneva Convention and in article 38 of the 1966 Arbitration Rules of the United Nations Economic Commission for Europe. Further, it has been recognized that "the Law applicable to the contract is, in international business relations, a delicate subject on which, at the end of lengthy negotiations, it may be difficult to reach agreement. Each party will prefer to have its own law be declared applicable, afraid of surprises the law of the other party may present. The question remains therefore often outstanding. It may even be a stimulant for insertion of an arbitration clause into the contract as the parties, not without good reasons, expect from the arbitrators that they will above all base their decisions on the wording and history of the contract and the usages of trade."³⁵ In accordance with the above arguments, the United States proposes the inclusion in this article of a new paragraph, based largely on article 33 (3) of the UNCITRAL Arbitration Rules, as follows:

"In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction."

Article 29.

Decision-making by panel of arbitrators

1. Finland, Sweden and (with regard to awards) IBA express the view that in the case where a majority of the members of the arbitral tribunal cannot be obtained, the presiding arbitrator should decide as if he were a sole arbitrator. In support of this view Sweden points out that, according to experience with the "majority rule", there is a risk that, in the event of three different opinions, the presiding arbitrator may be tempted to agree to a juridically dubious solution in order to attain the necessary majority. IBA recognizes that any change of the text regarding the method of decision-making would involve a change of policy which has already been settled, and it would also lead to a difference from the provisions of the UNCITRAL Arbitration Rules; nonetheless, it is suggested that this can give rise to a real problem, and that the parties can suffer a total waste of time and expense if the arbitration ends without any award being issued. It is believed that most practising lawyers would prefer to see the proposed solution.

2. For the cases where no majority can be obtained, the Republic of Korea proposes to redraft the second sentence of article 29 as follows:

"Except as otherwise stipulated in an arbitration agreement, in case the ayes and nays are equal, where there are several arbitrators, the arbitration agreement in question shall forfeit its effect."

3. Italy suggests allowing decisions to be made by correspondence; at least it would be necessary to provide that where an arbitrator fails to come to the agreed place without just cause the other arbitrators could proceed with the deliberations.

4. Norway, appreciating the intention of the provision contained in the last sentence of this article, suggests that the word "presiding" is unclear. It is proposed either to explain this word in the Model Law or, perhaps better, to delete it.

5. As to the proposal by Qatar to provide in article 11 of the Model Law a definition of the presiding arbitrator, see paragraph 3 of the compilation of comments on article 11.

Article 30.

Settlement

Austria and Mexico propose the deletion of the words "and not objected to by the arbitral tribunal" in article 30 (1). Austria considers that these words restrict the autonomy of the parties in an unjustified way since, if the subject-matter of the dispute is capable of being submitted to arbitration, the parties are free to settle the dispute without any restrictions by the arbitral tribunal. In the view of Mexico, the arbitral tribunal should not be able to oppose the recording in the form of an award of the settlement which the parties have reached.

Article 31.

Form and contents of award

1. Czechoslovakia suggests stating expressly that the award must be definite in order to exclude any uncertainty as regards the decision on the disputed claim. It further suggests adding a paragraph to article 31 as follows: "An award meeting all requisites in accordance with this article has the force of *res iudicata* and shall be enforceable in courts."

2. Norway expresses the opinion that the award ought to state whether any arbitrator has dissented. The dissenting arbitrator should be allowed to state in the award itself his reasons for dissenting. The proposal is to include in article 31 the following new paragraph:

"(3 *bis*) The award shall state whether it has been rendered unanimously. If the award has been rendered under dissent, it shall state the issue of the dissent and which arbitrator dissented. Any dissenting arbitrator is entitled to state in the award the reasons upon which his dissent was based."

³⁵Pieter Sanders, "Model rules for international commercial arbitration: UNCITRAL Arbitration Rules", *Proceedings of the Fifth International Arbitration Congress, New Delhi 1975*, part C.

*Article 32.**Termination of proceedings**Article 32, paragraphs (1) and (2)*

1. The Soviet Union states that from the juridical and technical point of view arbitral proceedings may be terminated by an award or by an order of the arbitral tribunal, but not directly by an agreement of the parties. Such agreement by the parties rather serves as a ground for an order for the termination of proceedings. For this reason it is proposed to move the reference to the agreement of the parties from paragraph (1) to paragraph (2) (a) of article 32.

Article 32, paragraph (2)

2. Austria suggests specifying in article 32 (2) (a) criteria for the withdrawal of a claim, in order to avoid uncertainty about the termination of arbitral proceedings. The following rewording of paragraph (2) (a) is proposed:

"(a) shall issue an order for the termination of the arbitral proceedings when the claimant withdraws his claim either before the communication of the statement of defence by the respondent or with the consent of the respondent if the latter has already communicated his statement of defence or by waiver of the claimant's rights to the subject-matter."

3. In the view of the Soviet Union, the reference in paragraph (2) (b) to the case where the continuation of proceedings becomes unnecessary or inappropriate is unclear. It is proposed to replace the word "inappropriate", which gives too much discretion to an arbitral tribunal, by the word "impossible" (following the example of article 34 (2) of the UNCITRAL Arbitration Rules) or by the word "pointless" or any similar word.

*Article 33.**Correction and interpretation of awards and additional awards*

1. Czechoslovakia proposes to restrict the provisions on the interpretation of the award to interpretation of the reasons upon which the award is based.

2. The German Democratic Republic proposes not to deal in the Model Law with the possibility of the interpretation of an award.

3. Sweden and the United States propose to reconsider this article with a view to establishing an obligation of the arbitral tribunal which has received a request from a party under this article, to give the other party an opportunity to respond to the request. While the suggestion of Sweden does not refer expressly to the making of an additional award, the proposal of the United States relates to all three cases of actions which may be requested from the arbitral tribunal under this article, i.e. correction and interpretation of awards and making of additional awards. As to the period of time to be allowed for a response to a request under this

article and for the ensuing action by the arbitral tribunal, Sweden regards a period of 30 days as too short; the United States proposes to provide that, unless the parties have agreed otherwise, the time for the arbitral tribunal to dispose of the request should commence to run after either objection to the correction, interpretation or additional award has been served on the arbitral tribunal or the time for serving said objection has expired.

CHAPTER VII. RECOURSE AGAINST AWARD

*Article 34.**Application for setting aside as exclusive recourse against arbitral award**Article as a whole*

1. The United States supports the policy of article 34, which provides a single remedy, to be exercised within three months after receipt of the award, for setting aside an award on the same grounds as those of article V (1) (a), (b), (c) and (d) and (2) of the 1958 New York Convention. It is considered appropriate to include among the grounds for setting aside the non-arbitrability of the dispute, as the Working Group has done. The present wording has the salutary effect of providing a single remedy of setting aside the award in the country in which it was made and, should the combined territorial-autonomy principle be adopted by the Commission, in the country whose arbitration law the parties have adopted. It also serves to align the grounds for setting aside with those for refusing recognition and enforcement.

Article 34, paragraph (1)

2. Austria, Finland, Germany, Federal Republic of, Japan, Norway and Venezuela suggest the deletion of the words "under this Law" placed between the second pair of square brackets. In making this suggestion, Finland and Norway refer to their views on the territorial scope of application of the Model Law (paragraph 1 of the compilation of comments on article 1), and Austria refers to its view on the scope of application of article 27 (paragraph 1 of the compilation of comments on article 27). In the context of this suggestion, the following is stated: the place of arbitration should be the exclusive determining factor for the applicability of the Model Law (Austria, Finland); the territorial criterion best corresponds to the practice of most countries (Finland); the place-related criterion is more practicable due to its specific nature (Federal Republic of Germany); doubts may arise with regard to the connection with the applied law when the conflict of laws rules of one State and the substantive law of another State or the substantive law of several States have been applied (Federal Republic of Germany); since it is probably in the interest of the States that the Model Law be complied with, and since the words "under this Law" open the possibility of proceeding

with an arbitration in a manner different from the one envisaged in the Model Law, preference should be given to the words "in the territory of this State"; these latter words would make the Model Law more effective because it would govern the arbitrations which are started in the State which has adopted the Model Law (Venezuela); the main reason for the suggestion is to make the criterion for the application of article 34 clearer to the court (Japan). Japan, however, expresses its understanding that the adoption of the suggested provision would not restrict the freedom of the parties to make arbitral proceedings governed by the arbitration law of a State other than the State where the arbitration takes place, and that the law which the court applies in setting aside an award rendered under the foreign arbitration law of the parties' choice may be that foreign arbitration law.

3. Of the two options presented in the square brackets, Mexico suggests the retention of the words "under this Law" since the meaning of the words "in the territory of this State" is already implied in article 1, and it is therefore superfluous to include these words in article 34.

4. It is proposed to retain both bracketed wordings (Czechoslovakia, Italy) and to link them by the conjunction "and" (Italy).

5. Mexico expresses doubt about the formulation of paragraph (1), which provides that the setting aside procedure is the only recourse to a court against the arbitral award, since article 36 (1) also provides recourse against "recognition or enforcement of an arbitral award", and article 16 (2) gives two other recourses: a plea that the arbitral tribunal does not have jurisdiction and a plea that the arbitral tribunal is exceeding the scope of its authority. It is suggested that this be clarified in article 34 (1).

6. The Federal Republic of Germany proposes to harmonize the wordings of articles 34 (1) and 36 (1) (a) (v) on the basis of the wording of article 34 (1).

7. Japan expresses the view that the "award" which is subject to setting aside under article 34 should mean only a final award on the merits of the case.

Article 34, paragraph (2) (a)

8. The proposals of Czechoslovakia, Italy and Sweden deal with the inclusion of other grounds for setting aside an arbitral award. Czechoslovakia proposes to add the following ground to the list in paragraph (2) (a): "the award contains decisions on matters which are impossible or prohibited under the law of the State". Italy proposes to consider including in the grounds for attacking an award the grounds for revision of an arbitral award which are provided, for example, in article 831 of the Italian Code of Civil Procedure (e.g. where decisive evidence withheld by the other party has been found after the judgement was rendered or where the judgement is based on evidence that is recognized to be false after the judgement was rendered). Sweden, noting that the provisions governing the setting aside of

an award appear to be exhaustive, is of the opinion that, for example, a challenge of an arbitrator or false evidence might also constitute grounds for setting aside an award. Sweden proposes to consider whether all errors providing a ground for setting aside an award should be treated in the same way. As regards certain grounds for setting aside, Sweden suggests that the requirement should be imposed that the error had affected the outcome or was otherwise of a serious nature.

9. In the view of India, article 34 appears to be unduly favourable to the losing party by providing too many grounds for attacking the award and a long period of time for applying to set aside the award.

10. The view of Cyprus is that the word "proper" in paragraph (2) (a) (ii) may give rise to problems of interpretation and that it should be expressly provided when a notice is not proper. The same comment is made in regard to article 36 (1) (a) (ii).

11. IBA suggests reconsidering paragraph (2) (a) (ii) with a view to substituting the words "given a full and proper opportunity to present his case" for the present words "unable to present his case". The proposed wording would correspond better with the equality provision in article 19 (3) (see also para. 8 of the compilation of comments on article 19, reflecting the comment of IBA on article 19 (3)).

12. Venezuela, noting that in the Spanish version of paragraph (2) (a) (ii) the words "*o árbitros*" are placed in parentheses, suggests that these words be retained without parentheses for the reason of clarity and because the parentheses may be interpreted as an indication of doubt as to the appropriateness of these words. This observation applies also to article 36 (1) (a) (ii).

Article 34, paragraph (2) (b)

13. Poland expresses doubt about the suitability of paragraph (2) (b) (i), which provides that the question whether a dispute is capable of settlement by arbitration is to be decided according to the law of the forum competent to set aside the award. While it is advisable to apply such rule to recognition and enforcement of an award, it should not be applied in proceedings to set aside the award because the consequences of setting aside are not limited to the State of the forum but extend very widely. It is proposed to consider replacing the words "under the Law of this State" by the words "under the rules of law applicable to the substance of the dispute".

14. In the view of India, the term "public policy" in paragraph (2) (b) (ii) is rather vague.

Article 34, paragraph (4)

15. Austria suggests the deletion of paragraph (4) because any action by the arbitral tribunal to eliminate the grounds for setting aside presupposes the setting aside of the defective award by the Court.

16. The United States endorses the policy of paragraph (4) designed to permit an arbitral tribunal, under appropriate circumstances, to cure such defects as might otherwise necessitate the setting aside of the award.

17. The German Democratic Republic suggests that the possibility of suspending court proceedings concerning the setting aside of an award should be regulated in more compelling terms in order to give the arbitral tribunal itself the opportunity to continue the arbitral proceedings or to eliminate the grounds for setting aside.

18. IBA suggests reconsidering paragraph (4) with a view to bringing it closer to the previous version of article 34 (4) as discussed by the Working Group at its last session.³⁶ This would establish a more clearly defined and workable basis for rescuing an award from nullity if the defect in respect of which recourse is sought is relatively minor, or remediable.

19. In the opinion of Japan, paragraph (4) is not clear as to the situations to be covered by it and should, therefore, be subjected to further study.

CHAPTER VIII. RECOGNITION AND ENFORCEMENT OF AWARDS

Appropriateness of retaining this chapter

1. Poland, besides expressing some reservations regarding the provisions on recognition and enforcement (see para. 7 and 11, below), approves the provisions as very progressive and favourable to arbitral awards made under the Model Law; it notes that the awards dealt with in the Model Law seem to have features of "international" arbitral awards rather than "foreign" awards as defined in the 1958 New York Convention.

2. The Republic of Korea is of the view that, because of the complex problems of jurisdiction and the scope of application, it would be better to replace paragraph (1) of article 35 by the following provisions dealing with the awards made in the territory of "this State", awards made outside the territory of "this State" under foreign law, and awards made outside the territory of "this State" under "this Law":

"(1) An arbitral award made in the territory of this State and under this Law shall have the same effect between the parties as a final judgement by a court.

"(1 bis) An arbitral award made outside the territory of this State under a foreign law shall be recognized in accordance with the principles of reciprocity and international comity by the decision of the court (or under the terms provided in the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards).

"(1 ter) An award made outside the territory of this State under this Law, or made in the territory of this State under a foreign law, shall be recognized for enforcement in this State by the decision of the court, taking account of international law as provided in article 38 of the Statute of the International Court of Justice, and taking account of all the relevant circumstances."

3. Austria suggests the deletion of the provisions of chapter VIII on recognition and enforcement of arbitral awards because the recognition and enforcement of awards made outside the territory of the State concerned is adequately dealt with in the 1958 New York Convention. Provisions on the recognition and enforcement of awards made in the territory of the State concerned are unnecessary since such awards have the same legal effect as court decisions; under Austrian law there are no special procedures for the recognition and enforcement of awards, so that an award is the basis for immediate granting of measures of execution.

4. Sweden queries the suitability of regulating the question of recognition and enforcement of awards in a model law, since the provisions of the Model Law on recognition and enforcement differ in some respects from those of the 1958 New York Convention. Since these differences may create problems for the States which have adopted the Convention, Sweden suggests the replacement of the regulation of these questions in the Model Law by a recommendation to the States that adopt the Model Law also to adhere to the Convention.

5. Finland is of the view that no provisions on recognition and enforcement of foreign awards should be included in the Model Law unless they are more favourable to recognition and enforcement than the provisions of the 1958 New York Convention. The reason is that a State which does not want to become a party to the Convention would not accept the Model Law. As to the awards made in the State where recognition or enforcement is sought, i.e. other than foreign awards, a refusal of recognition or enforcement should only be allowed on the grounds mentioned in article 36 (1) (a) (v) and 36 (1) (b).

6. IBA appreciates that, if an acceptable degree of harmonization is to be achieved, a relatively simple and well-defined basis both for actions for recourse and for actions for enforcement must be established. Furthermore, in order to be compatible with the present international régime, it is important that the operations of the 1958 New York Convention should not be disturbed; or, if it is to be disturbed, it should be done in a manner which can be well understood by the courts of countries adopting the Model Law and lawyers who practise within those jurisdictions. On balance, it is suggested that the Model Law should not in fact deal with the question of recognition and enforcement of foreign arbitral awards. This should be left to the 1958 New York Convention, and any improvements achieved either by amending the Convention by protocol or, as has been suggested,³⁷ by moving towards a more unified

³⁶A/CN.9/246, para. 126.

³⁷A. J. van den Berg, *The New York Convention of 1958* (Deventer, Kluwer 1981).

approach to the Convention. As regards enforcement of awards in international arbitrations held within the territory of the relevant State, article 35 is regarded satisfactory in so far as the mechanisms are concerned. However, attention is drawn to the fact that grounds for refusal of recognition or enforcement, as set out in article 36, are drawn directly from the provisions of the 1958 New York Convention. This Convention was specifically designed to cover the question of enforcement of foreign awards and assumed that such awards would have been subject to court supervision in the State in which they were issued. It is suggested that article 36 should be reviewed in the light of the fact that "domestic" awards will not have been subject to any court control in another State. In other words, if the question of enforcement of foreign awards is dealt with in a separate article which simply applies the criteria of the 1958 New York Convention (as is the case, for example, in the English Arbitration Act 1975), then a separate article could deal with the refusal of enforcement of a domestic award. Such a separate article would not proceed on the assumption that the award has been subject to court control in the State in which it was made.

7. Poland is of the view that there is an uncertainty as to how the 1958 New York Convention is going to be applied to the awards covered by the present chapter VIII of the Model Law, and that this uncertainty should be resolved by the Model Law.

8. Italy notes that, according to the definition provided in article 1 for the Model Law in general, articles 35 and 36 refer to awards rendered in international commercial arbitration. It suggests that this point be expressed in the text.

Requirement of reciprocity as a condition for recognition or enforcement

9. Czechoslovakia suggests adding a new provision stating that the awards made in a country other than the country where recognition or enforcement is sought may be recognized or enforced if reciprocal treatment is secured.

10. Norway, referring to its comments on articles 1 and 34 (see para. 1 of the compilation of comments on article 1 and para. 2 of the compilation of comments on article 34) where it favours that the criterion for the territorial scope of application of the Model Law should be the territory of the State in which the arbitration took place, states that a natural, if not necessary, consequence of this view would be to make the recognition and enforcement of foreign awards conditional upon reciprocity. It is suggested that consideration should be given to including such a condition in the text, at least in respect of foreign awards not based on the Model Law, i.e. awards in international commercial arbitration, as defined in article 1, based on procedural rules different from those of the Model Law. It is noted, however, that it is difficult to distinguish the international commercial awards which are based upon the Model Law from

those which are not, due to the very nature of the concept of the Model Law; if the uniform rules were to be adopted as a convention, one could probably distinguish easily between foreign awards which are based on the uniform rules (awards made in Contracting States) and those which are not.

11. Poland, noting that the Model Law does not provide a requirement of reciprocity in the recognition and enforcement of arbitral awards, expresses the view that this seems to be questionable and proposes to include in the Model Law the right of the signatories to make a reservation in this respect.

12. In order to avoid difficulties which might arise in the application of the Model Law, at least for some States, the Soviet Union considers it worthwhile to discuss the question of including in this article a provision that, following the example of the 1958 New York Convention, would allow the acceptance of the Model Law subject to the condition of reciprocity as regards the application of article 36 to international arbitral awards.

13. The United States, referring to a view of the Working Group expressed at its seventh session,³⁸ expresses the understanding that the freedom of any State to apply article 35 only on the basis of reciprocity, as expressed in its national legislation, is fully preserved.

"Double control" of awards

14. With regard to the right of a party to assert defences against recognition and enforcement of an award, the United States supports the prevailing view expressed at the seventh session of the Working Group to the effect that "a party should be free to avail itself of the alternative system of defences which was recognized by the 1958 New York Convention and should be maintained in the Model Law".³⁹ This means that such defences may be asserted either in a setting aside procedure, or in opposition to an application for recognition and enforcement of the award. In the discussion of articles 34 and 36 at the seventh session of the Working Group, a concern was expressed over the potential of conflicting decisions, during the initial three-month period following issuance of an award, stemming from the right of a party to oppose an award under either procedure, that of setting aside in the Court of article 6 or by way of objection to recognition or enforcement.⁴⁰ One of the solutions subsequently suggested was to provide for the mandatory adjournment of decisions on recognition or enforcement in the event that setting aside proceedings have been initiated. In the view of the United States, this problem of "double control" is already dealt with in a practical way by article 36 (2), which gives the court, where recognition or enforcement is sought, the discretion to adjourn its decision on the matter and, in appropriate cases, to order the other party to provide security.

³⁸A/CN.9/246, para. 144.

³⁹*Ibid.*, para. 154.

⁴⁰*Ibid.*, para. 152.

*Article 35.**Recognition and enforcement*

1. While India approves the uniform treatment of international awards irrespective of their country of origin, it suggests the inclusion of some provisions on the technical procedures for enforcement, taking into account the difficulties with the application of the 1958 New York Convention.

2. The Soviet Union notes that the Model Law contains no direct provision which would determine the moment in which an arbitral award made in "this State" becomes binding on the parties, and that article 35 (1), providing that "an arbitral award, irrespective of the country in which it was made, shall be recognized as binding", does not specify such moment. It is also noted that according to article 36 (1) (v), the recognition or enforcement of an award may be refused if it "has not yet become binding on the parties". It is suggested that, if an award is made in a foreign State, the question of when it becomes "binding" should be decided under the law of that foreign State and, if an award is made in "this State", this question should be decided on the basis of "this Law". It is therefore proposed to include an indication on this point by providing, for example, that the award is binding on the parties from the date it was made or from the date it was delivered to each party (article 31 (3) and (4)), or that the award, if it does not provide otherwise, is "subject to immediate enforcement", or something of this kind.

3. The United States supports the policy of article 35, which, in a single article, provides uniform conditions for the recognition and enforcement of awards in international commercial arbitration regardless of their place of origin. It is pointed out that, as noted by the Working Group at its fifth session, the inclusion of provisions dealing with recognition and enforcement not only of domestic but also foreign awards in the country adopting the Model Law, may be viewed as "an important step towards creating, in addition to the multilateral and bilateral network, a unilateral system of recognition and enforcement of foreign arbitral awards."⁴ The United States is satisfied that inconsistencies, if any, between the legal régimes of the Model Law and the 1958 New York Convention would be avoided by the wording of article 1 (1) which specifically provides that application of the Model Law is "subject to any multilateral or bilateral agreement which has effect in this State". The potential for conflict between the two régimes is further ameliorated by the "more-favourable-right" provision of article VII (1) of the 1958 New York Convention.

*Article 36.**Grounds for refusing recognition or enforcement**Article 36, paragraph (1)*

1. Argentina expresses the view that article 36 should be interpreted in the sense that an award would not be

recognized where the court finds that the arbitral tribunal had proceeded without jurisdiction or had infringed the exclusive jurisdiction of the court before which the recognition or enforcement is sought.

2. The United States, noting that article 36 (1) extends the scope of its provisions to international arbitration awards irrespective of their place of origin, suggests that a review of the provisions of this article shows that not all of the grounds for the refusal of recognition or enforcement may be equally applicable to both "domestic" and "foreign" awards. The United States considers that each of the provisions needs to be reviewed at the next session of the Commission in light of the decision still to be made on the territorial scope of application of the Model Law.

3. As to the view of Finland to restrict the grounds for recognition or enforcement of awards made in the territory of the State where recognition or enforcement is sought to the grounds mentioned in article 36 (1) (a) (v) and 36 (1) (b), see para. 5 of the compilation of comments on chapter VIII of the Model Law.

Article 36, paragraph (1) (a) (i)

4. In the view of Cyprus, the phrase in paragraph (1) (a) (i) "failing any indication thereon" calls for improvement; it is suggested to replace that phrase by the phrase "or failing such choice of law by the parties".

Article 36, paragraph (1) (a) (ii)

5. Cyprus makes two comments on paragraph (1) (a) (ii). One concerns the word "proper" and is reflected in para. 10 of the compilation of comments on article 34. The other one is on the words "was otherwise unable to present his case", which are considered to be very wide; it is thought that the causes of inability to present one's case ought to be expressly provided and that a discretionary power may be left to the court to refuse recognition and enforcement when it considers the alleged cause reasonable in the circumstances.

6. For a comment of Venezuela on the Spanish text of the Model Law applying equally to articles 36 (1) (a) (ii) and 34 (2) (a) (ii), see para. 12 of the compilation of comments on article 34.

Article 36, paragraph (1) (a) (iv)

7. In the view of Cyprus, the phrase in paragraph (1) (a) (iv) "the arbitral procedure was not in accordance with the agreement" is so wide that it affords a party a basis for complaining of minor deviations from the procedure.

8. In the opinion of Mexico, the phrase in paragraph (1) (a) (iv) "was not in accordance with the law of the country where the arbitration took place" is incongruent with paragraph (3) of article 11, which provides the procedure to be followed by the arbitral tribunal in the case where the parties have not agreed on such procedure. It is, therefore, not "the law of the country where the arbitration took place" which should be followed, but this law, i.e. the Model Law. More-

⁴A/CN.9/233, para. 129.

over, the proposed solution and the use of the suggested terminology would coincide with the provision of article 34 (2) (a) (iv).

Article 36, paragraph (1) (b) (ii)

9. India is of the view that the term "public policy" in paragraph (1) (b) (ii) is too vague and allows conflicting interpretations.

10. Qatar notes that article 36 governs the question of refusing recognition or enforcement of an award in any State which will adopt the Model Law and that, according to paragraph (1) (b) (ii), recognition or enforcement of an award may be refused where the recognition or enforcement would be contrary to the public order (or public policy) of the State concerned. It is considered that where an arbitral award is valid and binding in a country, so that the issue is limited to a simple recognition or enforcement of that award in another country, the public order of the country of recognition or enforcement should be observed to the narrowest extent, i.e. only with regard to the proceedings required for recognition or enforcement. The proceedings normally envisage a compulsory measure to secure payment of a pecuniary amount or other executory measures which in themselves, independently of the subject-matter of the dispute and the legal rules applied by the arbitral tribunal, do not constitute an encroachment upon the public order of a country. These legal rules, as they are applied to the subject-matter of the dispute, might be seen as inconsistent with the public order of the country of enforcement or recognition, although they are not inconsistent with the public order in the country where, or according to the law of which, the arbitral award was made. Where the rights of the parties are determined in pecuniary form, by recognition of a title, or in another way which does not in itself affect the public order in the country of recognition or enforcement, the public policy reason should not be used for refusing recognition or enforcement. Otherwise, this would mean reopening the consideration of the dispute in which a decision has already been made, and as a consequence of such action, arbitral proceedings would be wasted and the confidence necessary in transactions in general and in international transactions in particular would be shaken. In support of its view, Qatar notes that many States, among them the United States of America, have legislation and certain case law which provide for such restricted interpretation of public order. Consequently, Qatar suggests that the following text be inserted at the end of paragraph (1) (b) (ii):

"In deciding whether an arbitral award would be contrary to the public policy of the State, there shall be no reconsideration of the subject-matter of the dispute upon which a ruling has been made by that award and the decision shall relate only to the proceedings or actions that will be required by the recognition or enforcement."

Proposed addition to article 36

11. Norway proposes to insert the following new paragraph in article 36:

"(2 bis) If an application for setting aside the award has not been made within the time-limit prescribed in article 34 (3), the party against whom recognition or enforcement thereafter is sought may not raise any other objections than those referred to in this article, paragraph (1), sub-paragraph (a) (i) or (v) or sub-paragraph (b)."

C. Comments on additional points

Suggestions to add certain definitions

Counter-claim

1. Norway and the United States note that there is no reference to counter-claims in the Model Law and that the understanding of the Working Group was that any provision of the Model Law referring to the claim would apply, *mutatis mutandis*, to a counter-claim.⁴² Nevertheless, Norway proposes, for clarity and information, to include in article 2 a provision to the effect that, unless otherwise stated, any provision referring to claims shall apply, *mutatis mutandis*, to counter-claims; it is pointed out, however, that it would be necessary to make a careful examination as to exceptions to such principle equating the counter-claim with the claim. The United States considers it desirable that an explicit statement which permits and regulates counter-claims be included in the Model Law and it proposes that this be done either by adding a reference to counter-claims in article 23 (1) and (2) (also in article 16 (2)) or by the inclusion of a general provision in article 2 to the effect that all references to claims and defences apply, *mutatis mutandis*, to counter-claims.

2. Mexico proposes to add, after the first sentence of article 23 (1), dealing with the statement of defence in respect of particulars contained in the statement of claim, the words "or, where appropriate, to state a counter-claim".

3. Czechoslovakia suggests adding, at an appropriate place, the following provision:

"Until the end of the hearing the arbitral tribunal has the right to conduct the proceedings also on counter-claims covered by the arbitration agreement and on claims presented as set-offs in the form of a defence."

This State

4. Mexico proposes to add to article 2 a definition of the expression "this State", as used at various places in the Model Law, indicating that it means the country that has adopted the Model Law.

Party

5. India proposes that a subparagraph be added to article 2 defining "party" as a "natural or juridical person who has entered into an arbitration agreement, irrespective of whether that person is named or identified in the agreement".

⁴²A/CN.9/246, paras. 73 and 196.

Appointing authority

6. The German Democratic Republic observes that the term "appointing authority" is used in article 11 but not defined in the Model Law. It suggests that a definition of that term be included in article 2.

Award

7. Mexico proposes to specify in article 2 the types of decisions of an arbitral tribunal which are to be comprehended by the word "award" as used in article 34 (1) and other articles which may distinguish various kinds of awards (e.g. article 16 (3)). (As to which types of awards may be subject to setting aside under article 34, see comments by Austria, Norway and Poland on article 16 (para. 7 of the compilation of comments on article 16) and comments by Japan on article 34 (para. 7 of the compilation of comments on article 34)).

Suggestions for new provisions on additional issues

Calculation of time-limits

8. Norway proposes to include a general provision on the calculation of time-limits, in particular whether the first and/or the last day of the term should be counted and the extension of the period where it would otherwise expire on a *dies non juridicus* (reference is made to articles 28 and 29 of the Convention on the Limitation Period in the International Sale of Goods (New York, 1974)⁴³).

Burden of proof

9. The Soviet Union considers it worthwhile from a practical point of view, following the example of article 24 of the UNCITRAL Arbitration Rules, other known international and national rules, as well as arbitration laws, to include in the Model Law (for example, as article 24 *bis*) an indication to the effect that each party bears the burden of proof of those facts to which it refers, and that arbitrators are entitled to demand from the parties the presentation of additional evidence. While these questions may be resolved, at least indirectly, by the general rule contained in article 19 (2), the importance of these questions warrants that they be settled in the Model Law in a clearer and more direct way.

10. In order to clarify the responsibilities of the parties and of the arbitral tribunal, the United States believes that it would be useful to add to article 24 a statement regarding the burden of proof, namely that "each party shall have the burden of proving the facts relied on to support its claim or defence". The same language is found in article 24 (1) of the UNCITRAL Arbitration Rules. Absent such language, some parties may not be diligent or some arbitral tribunals might misconceive their role as being investigatory.

Evidence of witnesses

11. The United States proposes that two aspects of arbitral procedure, pertaining to the presentation of evidence by witnesses, be addressed by specific provisions of the Model Law. Firstly, it would be prudent to add a provision that "the arbitral tribunal is free to determine the manner in which witnesses are examined, unless the parties have agreed otherwise". This language is modelled on article 25 (4) of the UNCITRAL Arbitration Rules. This power is already implicit in article 19 (2) of the Model Law, which gives the arbitral tribunal discretion to conduct the arbitration in such manner as it considers appropriate, subject to the agreement of the parties and other provisions of the Model Law. However, the manner of questioning witnesses arises in almost every international arbitral proceeding, and it would be useful to have a specific provision which can be cited to support the position that this matter is for determination by the arbitral tribunal. Secondly, the United States suggests the inclusion of a provision that "evidence of witnesses may also be presented in the form of written statements signed by them". Inclusion of such a provision in the Model Law, as is done in article 25 (5) of the UNCITRAL Arbitration Rules, would clarify that this useful and at times necessary method of presenting testimony is available to parties in international commercial arbitration proceedings.

Conflicts of law issues

12. The German Democratic Republic observes that the Model Law does not contain rules on certain conflicts of laws, for example, rules on the law applicable to arbitration agreements and on the law applicable to awards on the merits, and that the preliminary drafts contained proposals for such rules which appeared to be appropriate to the nature and purpose of the Model Law. It is suggested that the advisability of having such rules be reconsidered.

Costs of arbitral proceedings

13. The German Democratic Republic, Qatar and Sweden suggest that the Model Law should deal with the question of costs of arbitral proceedings. In the view of the German Democratic Republic, the Model Law should regulate the principles in the matters of costs, including distribution of costs and the obligation to make advance payments, and that articles 38, 40 (1) and 41 (1) of the UNCITRAL Arbitration Rules could serve as a model for such regulation. Qatar proposes the inclusion of provisions related to the costs of arbitration, advance deposits for the costs and the apportionment of the final costs between the parties; stressing the importance of such provisions for the orderly conduct of international arbitration, Qatar suggests that the provisions to be included be modelled on articles 38 to 40 of the UNCITRAL Arbitration Rules. Sweden, considering the arbitration costs to be an important question, points out that the Model Law is fairly detailed in other aspects and that, therefore, the absence of provisions on costs appears to be a defect.

⁴³A/CONF 63/15.

14. As to a proposal by Finland to deal with the effect of a failure of a party to pay his share of the advance to the arbitrators, see para. 1 of the compilation of comments on article 11.

Other comments

Modification of and amendment to contracts

15. The Federal Republic of Germany observes that the question as to whether an arbitral tribunal should have the authority to modify a contract so as to adapt it to a changed situation or to amend it is being discussed on a broad international scale. It is the understanding of the Federal Republic of Germany that the absence of a provision on that point means that there is no intention to grant to the arbitral tribunal this sort of authority. The delegation of the Federal Republic of Germany advocated that there be no such provision in the Model Law, and it continues to hold that view. It is thought that the argument against the inclusion of a provision on this issue is not so much that an adaptation of contracts involves questions of substantive law while the Model Law is a law on procedure, but that the activity of the arbitral tribunal is concentrated on the interpretation and application of contractual agreements and legal provisions. The authority to modify and amend contracts, such as is given to the State courts of the Federal Republic of Germany, would often be the best way to arrive at a settlement of a dispute in terms of a just accommodation of interests. Nevertheless, a provision of this kind in the Model Law does not seem appropriate. If the parties have provided in the arbitration agreement for the possibility of making modifications or amendments in the contract, the arbitral tribunal can take the appropriate measures. An agreement of this kind does not have to be made *expressis verbis*; it may be derived from the significance and purpose of the agreement. However, if the parties do not want an arbitration of this kind, it should not be imposed on them.

Commentary on the model law

16. In the opinion of CEC it would be desirable that a report be adopted by the Commission in conjunction with the Model Law. Such report should, in its first part, explain the nature of the Model Law in the system of international law, indicate the procedure which may be used to incorporate the Model Law in a national legal system, and consider the relation of the Model Law, as incorporated in the legal system of a State, to international agreements entered into by the State and its relation to other legal rules on arbitration of the State. It is observed, however, that in view of the variety of legal systems which may adopt the Model Law, such report could only provide general guidelines directed principally to those States which are less familiar with the arbitral procedure. In its second part, the report should contain an article-by-article analytical commentary of the Model Law explaining briefly the reasons for adopting particular solutions.

Drafting

17. The Soviet Union expresses its understanding that attention will be paid at the session of the Commission to the need for establishing corresponding language versions of the Model Law, to the uniform use of terminology (e.g. the terms "country" and "State", especially in articles 35 and 36), to the titles of individual chapters and articles, and similar matters.

18. IBA suggests that the text should be reviewed to ascertain whether the words "territory", "country" and "State" are used appropriately in their respective contexts.

[A/CN.9/263/Add.1]

ADDENDUM

Introduction

1. This addendum to document A/CN.9/263 contains a compilation of those comments received between 31 January and 29 March 1985 from the following States and international organizations: Canada, Sudan, Yugoslavia; Asian-African Legal Consultative Committee (AALCC),¹ Hague Conference on Private International Law (Hague Conference)² and International Chamber of Commerce (ICC).³

2. The structure and the way of presentation used in this addendum are the same as those used in document A/CN.9/263.⁴

Analytical compilation of comments

A. General comments on the draft text

1. Canada expresses the view that the Model Law is a valuable step forward in promoting a simple, workable set of rules that will recognize and encourage international arbitrations. Overall, the Model Law is well designed to achieve the primary goals of international commercial arbitration, these being speed and reasonable costs of the proceedings, limited but effective judicial support, and neutrality of the proceedings. It contains a number of drafting and procedural problems, but none of them appear to reflect a concept which is unacceptable to Canada or to the underlying principles of Canada's two legal systems, the common law and the civil law.

¹The comments of AALCC reflect the unanimous or prevailing views expressed during the consideration of the draft text of the Model Law by its Sub-Committee on International Trade Law Matters at its twenty-fourth session (Kathmandu, Nepal, 7-12 February 1985).

²The comments were submitted by the Permanent Bureau of the Hague Conference. Where a comment, as on article 27, refers to the Hague Conference on Private International Law itself, the name of the international organization is not abbreviated.

³The comments of ICC were adopted by its Commission on International Arbitration on 29 November 1984.

⁴A/CN.9/263, paras. 4-6 of the introduction.

2. ICC is of the view that the disparity between various national arbitration laws and the difficulties for international businessmen in foreseeing how a dispute will be resolved within a specific legal system and enforced in another judicial system call for a harmonization of those laws that govern the settlement of disputes arising in international transactions. Important steps have already been taken through the many bilateral and multilateral agreements and conventions that are in existence. Harmonization should preferably be done through the elaboration of a model law rather than a convention, which, as experience shows, is less readily accepted by a great number of nations unless important reservations are made to it, thus diminishing its value as a uniform instrument. The need for a model law will be looked upon differently by those industrialized countries with a long commercial tradition and dispute settlement experience, on the one hand, and by countries which are entering the international trade community, on the other hand. ICC therefore believes that the Model Law should neither limit the freedom of parties to tailor their arbitrations nor suppress existing concepts and practices in different parts of the world. A model law should set a standard framework for what is universally accepted as being required to ensure due process of law, fairness and equality, i.e. the fundamental principles of justice. Therefore, in individual questions raised by the Model Law where there exist important differences in opinion, concepts and tradition amongst trading nations, ICC prefers leaving these to develop freely and unbound rather than changing present concepts and practices already in force in various countries. Thus, rather than a detailed regulation bringing a high degree of precision and certainty to a particular problem to which different solutions are given in various countries, ICC favours an attitude where the Model Law adopts a common denominator. A model law that forces solutions envisaged as foreign by the receiving nations is not likely to be generally accepted and would therefore be counter-productive.

B. *Specific comments on individual articles*

CHAPTER I. GENERAL PROVISIONS

Article 1. Scope of application

Territorial scope of application

1. AALCC, noting that the Model Law does not contain any provision on the territorial scope of application, is of the view that the Model Law should not incorporate territorial limits.

Model law yields to treaty law

2. AALCC recommends replacing in paragraph (1) the words "which has effect in this State" by the words "which is in force in this State".

Substantive scope of application: "international commercial arbitration"

"Commercial"

3. With respect to the definition of "commercial", Canada recognizes that, although it is not usual statutory drafting practice to place definitions in footnotes, any jurisdiction which decides that a definition of "commercial" is necessary in its arbitration legislation will apply its own techniques of drafting and interpretation in that regard. It is the view of Canada that business activities of Governments and their agencies, including sovereign risk loans, are included in the definition of "commercial". If it is not intended that such governmental activities or loans be covered by the definition, this should be made explicit. It would seem preferable to provide that such activities come under the Model Law, leaving it open to a Government which wishes to exempt itself to identify this fact in its legislation.

4. AALCC recommends that, instead of an illustrative list, a definition of the term "commercial" should be given and included in the text of article 1 itself.

5. In the view of ICC, the technique of leaving the definition of the term "commercial" in a footnote is not advisable. The term is essential to the scope of the Model Law and should find its place in the law itself. ICC is not of the opinion that the law must bring about a harmonization of the concept "commercial". On the contrary, various interpretations and meanings given by different countries must be respected, but the law should elaborate on the definitions so that the examples which will eventually be included in the Model Law are precise and provide guidance to the persons involved in arbitration. ICC adds that it seems indispensable for the usefulness of the Model Law to indicate whether it applies to commercial transactions undertaken by sovereign States and State-owned enterprises.

"International"

6. As to the term "international", the view of ICC is that the present compromise solution in article 1 (2) is acceptable. ICC interprets it as covering the common case where two parties having their places of business in the same country enter into a contract which has to be performed abroad.

Places, other than place of business, determining international character of arbitration (article 1, paragraph (2) (b))

7. Canada notes that some of those consulted, including its provincial governments, expressed concern that under paragraph (2) (b) an arbitration became international merely by virtue of the fact that the place of arbitration was selected outside of the jurisdiction. This could permit a type of "forum shopping" which could prove unacceptable to some jurisdictions.

Yet other international link (article 1, paragraph (2) (c))

8. In the view of Canada, paragraph (2) (c) is too vague. Canada is uncertain what the subparagraph is intended to accomplish and believes it is unlikely that many jurisdictions, especially those that follow the common law, would enact such a provision.

9. Yugoslavia is of the opinion that the definition of the term "international" contained in article 1 is too broad since, according to paragraph (2) (c), an arbitral award is considered international where both parties have their places of business in the same State provided that "the subject-matter of the arbitration agreement is otherwise related to more than one State". In addition, the definition of international commercial arbitration implies that the arbitral tribunal may examine issues of substance in order to determine its competence, which is contrary to the existing international practice. Since such a solution could create complex situations, it is suggested simplifying article 1 so as to ensure effective determination of the arbitral tribunal's competence. The solutions contained in article 1 are contrary to Yugoslav laws and regulations, and it is feared that this can be one of the reasons for a negative attitude towards the Model Law as a whole. The definition contained in article 1 is reflected particularly in articles 35 and 36, according to which a domestic award may in some cases be subject to the *exequatur* procedure, which is contrary to the practice in Yugoslavia as well as in many other countries. It is suggested that the definition contained in article 1 should be re-examined and reformulated in accordance with the existing international practice and the solutions provided in existing conventions relating to recognition and enforcement of foreign arbitral awards.

Article 2.

Definitions and rules of interpretation

Article as a whole

1. AALCC, noting that article 2 sets forth definitions of certain terms and rules of interpretation, recommends that the definitional provisions and those provisions setting forth rules of interpretation should be divided into two independent articles entitled "Definitions" and "Rules of interpretation". It would be appropriate to place the article containing the rules of interpretation towards the end of the Model Law.

Article 2, subparagraph (c)

2. In the view of the Hague Conference, subparagraph (c) seems hardly compatible with article 28 of the Model Law. The freedom of the parties to choose the law applicable to the substance of the dispute constitutes a fundamental principle of private international law. It seems not desirable to permit the parties, by a provision in the Model Law, to entrust this choice to a third party or, even less desirable, to an institution such as the International Chamber of Commerce (which, moreover, would have to declare itself not competent in the matter). The possibilities should be limited in that

either the parties choose the applicable law, and this choice is to be respected by the arbitral tribunal, or, failing any designation by the parties, the arbitral tribunal, and only it, determines the applicable law according to article 28 (2). (It is observed that it is not necessary, in this context, to discuss whether an authorization given to an arbitral tribunal to choose freely the law applicable to the substance of the dispute, without any reference to a conflicts rule, is equivalent to an authorization, as dealt with in article 28 (3), to decide as *amiable compositeur*.) The provision of article 2 (c) should therefore be modified by a reservation concerning article 28.

Article 2, subparagraph (e)

3. Canada expresses the view that the modalities of delivery by each system described in subparagraph (e) will have to be considered by each State, having regard to the rules of delivery it accepts in the case of judicial procedures and to local circumstances. For example, Rules of Court may deem service to take place within a certain number of days following the date of posting.

Article 4.

Waiver of right to object

1. In the view of Yugoslavia, the general rule on presumed waiver of the right to object can constitute an unjust and heavy sanction which, at the same time, gives considerable power to the arbitral tribunal. The requirement "without delay" is too strict, particularly when the party is from a developing country, since it results in an extremely unfavourable position for a party which has failed to object. It is suggested that, instead of having a general rule on a party's failure to object, the failure of a party should be assessed in each specific case, taking into account all relevant circumstances.

2. AALCC expresses the view that the term "without delay" is vague and that it would be appropriate if some time-limit were indicated.

3. Canada observes that the English language version of this article seems less than clear to the reader. The question is whether it means non-compliance with the law or with the agreed upon derogation. If it means the former, then the question is whether the clause should not read "from which the parties may not derogate" rather than "from which the parties may derogate". However, the French language version would appear to indicate that it is the latter which is intended; if this is true, the ambiguity in the English language version could be removed by adding, after the word "non-compliance", the words "with the agreed upon derogation or requirement under the arbitration agreement".

Article 5.

Scope of court intervention

AALCC suggests modifying the heading of article 5 so that it would read "Limitation of court intervention".

Article 6.

Court for certain functions of arbitration assistance and supervision

1. Yugoslavia, noting that this article deals with the competence of the Court within a legal system and not the question of its international jurisdiction, proposes formulating a solution according to which, in the first place, international jurisdiction would be given, in principle, to the Court of the State to whose procedural law the parties have agreed to subject their arbitration, and, in the absence of such an agreement, the jurisdiction would depend on the place of arbitration. It is noted that a problem would arise where the parties have not reached such an agreement and where the place of arbitration has not been determined, if there is a need for court intervention before the arbitral proceedings have commenced.

2. AALCC expresses the view that it should be made clear that the courts designated by the national authority should have the jurisdiction to deal with matters concerning the Model Law. It is suggested modifying this article as follows:

"Article 6. Courts with jurisdiction to perform the functions provided in the Model Law"

"The courts with jurisdiction to perform the functions provided in the Model Law shall be . . ."

CHAPTER II. ARBITRATION AGREEMENT

Article 7.

Definition and form of arbitration agreement

Article as a whole

1. AALCC recommends splitting this article into two articles, one dealing with the definition of an arbitration agreement and the other with the form of the arbitration agreement.

Article 7, paragraph (1)

2. In the opinion of Canada, the word "defined" in connection with the words "legal relationship" appears to raise a question. The expression "defined legal relationship" does not convey any particular concept in common law, and it raises a question as to where the legal relationship was defined—in a statute, a contract or elsewhere. It is, therefore, asked whether this word is necessary.

3. AALCC recommends replacing in paragraph (1) the expression "defined legal relationship" by the expression "defined legal issues" or "defined legal disputes".

Article 7, paragraph (2)

4. In the opinion of Canada, paragraph (2) should provide for paperless transactions, i.e. automatic data processing in international trade.

5. Canada observes that where a contract incorporates the terms of another contract and that other contract contains an arbitration clause, there has in practice been uncertainty as to whether the arbitration clause has been incorporated in the first contract. It is assumed that this incorporation by reference is now covered by the language contained in paragraphs (1) and (2), but if there is any doubt, it should be made explicit that it is so covered by the article. One way to do this might be to add language to paragraph (2) to the effect that where a contract incorporates the terms of another contract and the other contract contains an arbitration clause, the arbitration clause shall be deemed to be incorporated in the first contract.

6. AALCC, regarding the question whether a signature on a document should be handwritten or could be effected by mechanical means, recommends that the mode of signature should be left to the national laws.

7. Yugoslavia suggests supplementing this article so as to enable the parties, in spite of non-compliance with the requirement of written form, to validate the arbitration agreement (e.g. by taking part in a hearing on the substance of the dispute without objecting, or by a statement of the defendant, entered in the record of the arbitration, that he submits to the jurisdiction of the arbitral tribunal). The provision on the written form contained in this article should make clear that it should not be interpreted as a provision aimed at protecting public interests but as one aimed at protecting private interests. It is observed that the rules requiring evidence of the arbitration agreement in the *exequatur* proceedings (article 35) can be softened by providing that the party requesting recognition or enforcement must give evidence of a valid submission of the other party to arbitration, which does not necessarily mean that a written arbitration agreement has to be presented as evidence.

Proposed addition to article 7

8. ICC, noting that the Model Law is intended to be enacted in countries with different judicial systems and rules of interpretation, expresses the view that the jurisdiction of arbitral institutions ought to be preserved in the clearest possible terms, and that there should be a provision on the possible conflict between the rules of the Model Law and the rules of the institution. It is proposed adding the following paragraph to article 7:

"(1 bis) Where the parties have agreed to refer all or any of the disputes specified in article 7 (1) to arbitration administered by a permanent arbitral institution, the arbitration shall be conducted in accordance with, and be governed by, the rules of such arbitral institution in so far as these are not contrary to, or inconsistent with, the mandatory provisions of this Law, which, in case of conflict, shall prevail."

*Article 8.**Arbitration agreement and substantive claim before court**Article 8, paragraph (1)*

1. Canada expresses the view that paragraph (1) is not clear. The question is whether it is intended to provide for only a stay of the action or for its total removal from a court, or whether it is, perhaps, intended to leave this question for determination by the legislature adopting the Model Law.

2. Yugoslavia observes that, where the State court finds that it has no competence to decide the dispute, it is not customary for the court to instruct the parties to approach a certain institution for the purpose of settling their dispute. This should be left to the parties. Resort to arbitration may not be the only (or best) solution for the parties.

3. AALCC suggests deleting the words "incapable of being performed" since they are considered as superfluous.

Article 8, paragraph (2)

4. AALCC recommends re-formulating paragraph (2) as follows:

"Where, in such cases, arbitral proceedings have already commenced, the arbitral tribunal shall continue its proceedings unless the court grants an interim order to suspend the proceedings."

CHAPTER III. COMPOSITION OF ARBITRAL TRIBUNAL

*Article 10.**Number of arbitrators*

1. The Sudan proposes, for the sake of comprehensiveness and clarity, adding the following new paragraph to article 10:

"(3) Notwithstanding paragraph (1) of this article, where the arbitral tribunal is constituted of more than one arbitrator, the number of arbitrators shall be uneven."

The proposal is meant to deal with the possibility that the parties appoint an even number of arbitrators in their agreement.

2. ICC expresses the view that, since the parties may agree on any number of arbitrators, provision ought to be made for the question how, failing an agreement by the parties, the appointment should be made. The present provisions in article 11 (3) provide only for the most common cases of one or three arbitrators. A general rule seems to be required for the appointment of an even number of arbitrators and of an uneven number of arbitrators in excess of three.

*Article 11.**Appointment of arbitrators**Article 11, paragraph (1)*

1. The Sudan proposes replacing in paragraph (1) the clause "unless otherwise agreed by the parties" by the clause "however, if a sole arbitrator is to be appointed, such arbitrator shall be of a nationality other than the nationality of the parties". This provides more clarity and satisfaction.

Article 11, paragraph (3)

2. In the view of Canada, paragraph (3) should provide specifically that an arbitrator may be appointed, even after the expiry of the period of time, right up to the time a request is made to the Court. As presently drafted, paragraph (3) implies that, after the expiry of the specified period of time, a party cannot appoint an arbitrator, or the two arbitrators that have been appointed cannot appoint a third arbitrator. It is also asked whether, in practice, 30 days is a long enough period of time to allow the two arbitrators, who have been appointed, to appoint the third one.

3. ICC notes that the Model Law does not require expressly that the arbitrators shall be independent of the parties and impartial. While it is true that article 11 (5) provides that a Court, when asked to intervene, shall secure the appointment of an independent and impartial arbitrator, nothing in the Model Law excludes the possibility that the parties themselves appoint somebody who is not independent or impartial, for example, their counsel. Although, according to article 12, an arbitrator should disclose circumstances that may cast doubt on his impartiality and independence, an express provision that all arbitrators must be impartial and independent is preferable.

*Article 12.**Grounds for challenge**Article as a whole*

1. Canada, noting that the English language version of this article uses the expression "justifiable doubts" in paragraphs (1) and (2) as an equivalent of the French language expression "*doutes légitimes*", observes that the expression "justifiable doubts" creates difficulties of application for an English-speaking common law lawyer. In the opinion of Canada, the expression "reasonable doubt" would be a more appropriate expression to convey the meaning intended by the article. Furthermore, it is suggested that the requirement of disclosure in paragraph (1) should be more stringent than that of paragraph (2), with a bias in favour of disclosure in paragraph (1), and that article 12 should be revised accordingly.

2. The Sudan submits that article 12 would be more comprehensive if the following wording were added at its end:

"Such circumstances include, but are not limited to, any financial or personal interest in the outcome of the arbitration or any commercial tie with either party or with a party's counsel or agent, if any."

Article 12, paragraph (2)

3. Yugoslavia is of the view that the grounds for challenge of arbitrators should be widened. Article 12 (2) specifies only doubts as to impartiality and independence, which is good but insufficient. It should be provided that an arbitrator can be challenged if he does not perform his functions without undue delay or, in the case of permanent arbitral tribunals, in compliance with the rules.

Article 13. Challenge procedure

Article 13, paragraph (1)

1. ICC observes that, although paragraph (1) leaves freedom to the parties to agree on a challenge procedure, paragraph (3) unfortunately limits the scope of the freedom considerably by giving a party the right to request the Court to decide on the challenge if the challenge under the procedure agreed upon is not successful. In the opinion of ICC, this limitation of the parties' right to agree on the challenge procedure is undesirable for the following reason. Parties prefer arbitration to court proceedings, among other reasons, because of its confidential character. If a State Court is to try a case according to paragraph (3), it is feared that the dispute will become public (parties' identity, amount in dispute, etc.) with sometimes devastating effects to the parties' image and financial position. Dilatory tactics must be curtailed. Arbitration would become less attractive to the parties, if desirable at all, where arbitration proceedings could be held up and matters sent to a State Court by simply challenging, *bona* or *mala fide*, an arbitrator; arbitration would also become less attractive to the arbitrators, knowing that their competence and ethics are at risk of being discussed publicly in a Court every time they accept to arbitrate. The model law should therefore treat different cases differently. Recourse to Court is acceptable in *ad hoc* arbitrations, but parties should be free to exclude such intervention where the institutional rules they have chosen contain provisions in this respect.

Article 13, paragraph (2)

2. Yugoslavia and ICC object to paragraph (2), according to which the arbitral tribunal, including the challenged arbitrator, decides on the challenge. ICC is of the view that arbitrators should not be their own judge in matters of challenge. Yugoslavia observes that it is hard to expect an arbitral tribunal to be objective if the arbitrator whose challenge is requested participates in the decision-making; this is particularly so where a sole arbitrator is challenged. In the view of Yugoslavia, it seems to be more appropriate, at least in the case of a permanent arbitral institution, that a governing council or an *ad hoc* body should make decisions in such matters.

Article 13, paragraph (3)

3. Canada, with regard to the provision in paragraph (3) that the decision of the Court shall be final, poses the question whether it means a "final decision" of the Court and, therefore, one subject to appeal to a higher court, or whether it means that the decision itself is final and cannot be appealed. The provision is unclear, at least in a common law context, and should be clarified. If the second meaning is the one intended, the paragraph might convey it better if the words "and binding" were added after the word "final".

4. The Sudan is of the opinion that it would be safer and more just to add the following text at the end of paragraph (3): "only where such continuance does not prejudice the claim or defence of the challenging party".

Article 14. Failure or impossibility to act

1. It is the view of Canada that the procedures in articles 13 and 14 should mesh. At present, the relationship of article 14 to article 13 is not entirely clear. For instance, one may ask whether the apparent bias of an arbitrator might be regarded as a *de jure* impossibility to act.

2. In the view of ICC, present article 14, dealing with *de jure* or *de facto* impossibility of an arbitrator to act and giving exclusive jurisdiction to the State Court where a controversy remains regarding the termination of the arbitrator's mandate, is not compatible with those rules of arbitral institutions which provide that, in such cases, the institution takes a final decision. ICC proposes that article 14 be modified so as to give the parties the freedom to agree on the procedure to be followed and to give jurisdiction to the State Court only as a last resort in case the agreed upon procedure for some reason fails (as is done in article 11 (4) of the Model Law). It is noted, however, that since parties may agree on the termination of the mandate of an arbitrator (article 14, first sentence), article 14 might be interpreted as meaning that the mere fact that the parties submit a dispute to the rules of an arbitral institution implies that they have given the institution the power to decide the issue (by virtue of article 2 (c) giving the parties the right to authorize an institution to make a determination for the parties). If it is considered impossible to amend the Model Law so as to give jurisdiction to the State Court only as a last resort, and if the interpretation noted above is correct, it would be desirable, if possible, to make a record of that interpretation.

3. Canada is of the view that, in an arbitration with three arbitrators, a party ought to be able to request the other members of the arbitral tribunal to terminate the mandate of the third arbitrator before being required to request the Court to do so, in order to reduce the necessity of petitioning the Court.

4. The Sudan proposes adding the following new paragraph to article 14:

"(2) If the sole or presiding arbitrator is replaced for any of the reasons embodied in the above paragraph, any hearings held previously shall be repeated. Likewise, if any other arbitrator is replaced, such prior hearings shall be repeated at the discretion of the arbitral tribunal."

5. AALCC, in view of its suggested re-formulation of article 6 (see paragraph 2 of the compilation of comments on article 6), observes that certain consequential amendments would need to be incorporated in this article, namely "the Court specified in article 6" would need to be replaced by "the Courts specified according to article 6".

Article 14 bis

AALCC recommends that the opening words "The fact that" should be deleted as superfluous.

Article 15.

Appointment of substitute arbitrator

The Sudan, noting that article 15 does not provide a period of time for the appointment of a substitute arbitrator, proposes adding, after the words "a substitute arbitrator shall be appointed", the following words:

"provided that such appointment shall be made within one month from the date of the termination of the mandate of the arbitrator being replaced".

For linguistic reasons, the words "arbitrator being replaced", contained in the wording that follows the proposed addition, should be replaced by the words "such arbitrator".

CHAPTER IV. JURISDICTION OF ARBITRAL TRIBUNAL

Article 16.

Competence to rule on own jurisdiction

1. AALCC recommends that this article be entitled "Competence".

2. Canada expresses the view that paragraph (3) seems unduly restrictive in limiting the right of a party to contest a finding of jurisdiction to an action to set aside the award. The acceptance of such a principle is unlikely in any Canadian jurisdiction because it is considered that the resolution of jurisdictional issues should not have to await the final award. A party should be able to deal with the question of jurisdiction as a preliminary matter. The problem with leaving it to the enforcement State is that there will be a difference between those States that are parties to the 1958 New

York Convention and those that are not. Furthermore, the recent decision of the French Court of Appeal in Paris in the case *Arab Republic of Egypt v. Southern Pacific Properties, Ltd. et al.* (International Legal Materials, vol. 23, no. 5, September 1984, pp. 1048-1061) illustrates the importance of resolving such questions at an early stage. Paragraph (3) should be revised to address this problem, perhaps by providing that an arbitral tribunal can refer the question of its jurisdiction to the Court.

Article 18.

Power of arbitral tribunal to order interim measures

1. The Sudan proposes the following text, which is an amalgamation of different international arbitration rules, in replacement of the text of this article:

"Unless otherwise agreed by the parties, the arbitral tribunal, on its own motion or at the request of either party, may take any interim measure of protection as it considers fit in respect of the subject-matter of the dispute, such as ordering the deposit of goods, if any, with a third party or the opening of a banker's credit or the sale of perishable goods."

2. AALCC recommends that the title of this article be "Interim measures", and proposes re-formulating the text of the article as follows:

"Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of one of the parties, order such interim measures of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute. The arbitral tribunal may require any party to provide security for the cost of such measures."

3. Canada suggests, in the interest of clarity, that this article be combined with article 9.

CHAPTER V. CONDUCT OF ARBITRAL PROCEEDINGS

Article 19.

Determination of rules of procedure

Article 19, paragraph (2)

1. In the opinion of Yugoslavia, it seems insufficient to restrict the power of the arbitral tribunal to conduct the proceedings in such manner as it considers appropriate only by providing that the parties are to be treated with equality and given a full opportunity of presenting their case. The arbitral tribunal should be obliged to respect a wider scope of minimum-standard procedural rules of the legal system to which the parties agreed to submit the arbitration, or, in the absence of such agreement, of the legal system in whose territory the arbitration takes place. The procedural rules of the applicable legal system which provides the grounds for setting aside of the award may be inspiring in determining such minimum-standard rules.

Article 19, paragraph (3)

2. In the view of the Sudan, the following addition would be important at the end of paragraph (3): "on his own or through a counsel or agent".

*Article 20.
Place of arbitration*

AALCC is of the view that the best practical solution to the concern raised by member States of AALCC, namely that article 20 may work to the disadvantage of parties from developing countries, would be to append a footnote to paragraph (1) of article 20, as follows:

"The Asian-African countries are recommended to include in their agreements the use of Cairo and Kuala Lumpur Arbitration Centre and any other Centre established by the Asian-African Legal Consultative Committee, as a venue of arbitration."

*Article 21.
Commencement of arbitral proceedings*

Canada observes that this article is illustrative of the reason why the matter of deemed receipt in article 2 (e) is very important for each jurisdiction to resolve (as to Canada's comments on article 2 (e), see para. 3 of the compilation of comments on article 2). It is suggested that the words "or deemed to have been received" be inserted in article 21 between the words "is received" and the words "by the respondent".

*Article 22.
Language*

Article 22, paragraph (1)

1. AALCC recommends an expansion of paragraph (1) of this article to provide for the situation where, failing agreement by the parties, the language of one of the parties is not the language, or among the languages, chosen by the arbitral tribunal for use in the arbitral proceedings. In this situation, this party should have the right to have translations of the proceedings into his own language at his own expense.

2. ICC is of the opinion that paragraph (1) ought to be modified so as to make clear that a party may express himself in any language he chooses provided he arranges for interpretation into the language to be used in the proceedings, as decided by the arbitrators. It is of fundamental importance in an international arbitration that, failing an agreement by the parties, each party is given a full opportunity of presenting his case in the language he chooses.

*Article 23.
Statements of claim and defence*

Article 23, paragraph (2)

1. AALCC recommends that the words "or supplement" be added in paragraph (2) between the words "to

allow such amendment" and the words "having regard to the delay".

Proposed addition to article 23

2. AALCC recommends that the following new paragraph be added to article 23:

"(3) In any case the court may fix a date before which the parties shall present their documents and their final statements."

*Article 24.
Hearings and written proceedings*

Article 24, paragraphs (1) and (2)

1. Canada observes that the drafting of paragraphs (1) and (2) can be confusing to the reader. In the absence of a contrary agreement, a party should have the right to an oral hearing. This should not be in the discretion of the arbitral tribunal. Even if the parties have agreed previously not to have oral hearings, a party should still be able subsequently to require an oral hearing (on terms and conditions—such as costs—which could be established by the arbitral tribunal) in the interest of giving him a full and fair opportunity to present his case. In any event, the arbitral tribunal should always have the power to order an oral hearing on its own initiative if it feels such a hearing is necessary to get out all the evidence to reach a proper decision in the dispute. Although *pacta sunt servanda* is an extremely important principle, which should be overridden only in rare instances, the achievement of a just resolution of a dispute is also an objective which ought not to be disregarded. This is especially so in a case where the parties may have agreed early in their contractual relationship to arbitration with no oral hearings without being able to foresee the nature of the difficulties that subsequently arise in that connection. In all cases, it is very important that sufficient advance notice should be given before oral hearings are held.

Article 24, paragraph (4)

2. In the view of Canada, the expression "expert report or other document", as used in the second sentence of paragraph (4), is too vague. It is suggested that more clarity is required as to what other kinds of documents are to be covered.

3. Since paragraph (4) is not clear as to whether the documents supplied to the arbitral tribunal are required to be submitted to the other party in original or copies thereof and whether the other party has the right to examine them, AALCC recommends the deletion of the reference to "documents" or "document" from paragraph (4) and the addition of the following provision as paragraph (5):

"(5) Each party shall have the right to examine any document presented by the other party to the arbitral tribunal. Unless otherwise decided by the arbitral tribunal, copies of such documents shall be communicated by the supplying party to the other party."

Proposed addition to article 24

4. The Sudan suggests that the following new paragraph be added to this article:

"(5) Subject to any agreement of the parties to the contrary, the hearings shall be held *in camera*."

*Article 27.**Court assistance in taking evidence*

1. The Hague Conference welcomes the decision of the Working Group not to include in the Model Law a provision on international court assistance in taking evidence.⁵ The delegates in the Working Group recognized, in the view of the Hague Conference with good reason, that the problem of international court assistance in taking evidence fell within the domain of international co-operation and that, therefore, it did not seem possible to deal with and organize such co-operation by a model law, which, by its nature, was intended to become a national law. In fact, international co-operation could only be based on a convention which provided clearly defined international obligations. It is pointed out that the Hague Conference on Private International Law, at its fifteenth session in October 1984, decided to include in the agenda of one of its future sessions the discussion of the possibility of using the Convention on the Taking of Evidence Abroad in Civil or Commercial Matters (The Hague, 1970) for arbitral proceedings. The Hague Conference on Private International Law is aware that a possible extension of the scope of the Convention of 1970 to arbitral proceedings, for example, by a protocol to the Convention, depends ultimately on whether the interested international arbitration circles consider it useful to have such international instrument. With respect to this question, the Hague Conference on Private International Law intends to consult with international organizations dealing with arbitration and the member States of those organizations. For this purpose, the Hague Conference on Private International Law requested a special commission to conduct an exchange of views on the possibility of using the Convention of 1970 in aid of arbitration for the taking of evidence abroad. This special commission will meet at the Hague from 28 May to 1 June 1985 and will, at this stage, include only the Central Authorities provided for by the Convention of 1970; it would be appropriate to know, initially, whether a broadening of the scope of the Convention of 1970 to cover arbitral proceedings is technically feasible. The Hague Conference envisages convening a second session of this special commission, which should then include arbitration experts and which should express its view on the substance of the problem. The Hague Conference would, of course, appreciate if the States members of the United Nations Commission on International Trade Law and observers at the eighteenth session of the Commission, when discussing article 27 of the Model Law, would express their opinion on the problem.

2. Canada notes, with respect to paragraph (2), that in May 1985 the Hague Conference on Private International Law will be considering the question of taking evidence abroad in the case of an arbitral proceeding.

3. AALCC recommends modifying in paragraph (1) the opening phrase of the second sentence, "The request shall specify", so as to read "The request shall be in conformity with the rules accepted before the court and shall specify".

CHAPTER VI. MAKING OF AWARD AND TERMINATION OF PROCEEDINGS

*Article 28.**Rules applicable to substance of dispute**Article 28, paragraph (2)*

1. In the view of ICC, paragraph (2) of this article is not consistent with modern practice in international commercial arbitration. The model law requires the arbitral tribunal to apply a law, i.e. the law of a State, and the arbitral tribunal must choose a conflict of laws rule to determine the applicable law. In finding the law applicable to the merits of the case, arbitrators do not necessarily first decide on an existing conflict of laws rule but find the appropriate law on substance by more direct means. This development has been made possible by the great freedom allowed by national laws and international regulations. ICC holds that to introduce strict limitations in the Model Law would be detrimental to the further development in this domain and would be regarded by many international arbitrators and practitioners as a step backwards. ICC proposes that the arbitral tribunal, failing any designation by the parties, should apply the rules of law that it considers applicable in the particular case.

Proposed addition to article 28

2. In the view of Yugoslavia, article 28 should be supplemented, along the lines of article 33 (3) of the UNCITRAL Arbitration Rules, so as to require the arbitral tribunal also to take into account "the usages of the trade applicable to the transaction".

*Article 29.**Decision-making by panel of arbitrators*

1. Canada observes that this article refers for the first time to a "presiding arbitrator", which raises the question of how the presiding arbitrator was appointed. This procedural gap could be rectified in article 11.

2. Yugoslavia observes that the formulation of the second sentence of article 29 might imply that the presiding arbitrator is empowered to make the decision on the merits of the case, which certainly is not intended. This article should be reformulated so as to make clear that it refers to the role of the presiding arbitrator as regards the procedure.

⁵A/CN.9/246, para. 96; A/CN.9/245, para. 43

3. ICC notes that the Model Law provides for decisions by a majority of the arbitrators, whereas under certain existing arbitration rules the chairman of an arbitral tribunal can decide alone where no majority can be obtained. Since the provision in article 29 is not mandatory, article 31 (1), which requires the signatures of a majority of the arbitrators in arbitral proceedings with more than one arbitrator, should be amended accordingly.

4. AALCC recommends that the title of this article should be "Decision-making".

Article 30. Settlement

Article 30, paragraph (1)

1. Canada poses the question whether the request of the parties mentioned in paragraph (1) must be a joint request or whether it may be made by either of the parties. If the former, a party might easily block the arbitral tribunal from recording a settlement in the form of an arbitral award. It would seem preferable that article 30 should provide that either party has the right to make such a request.

2. In the view of Yugoslavia, it would be necessary to determine, at least by using general terms, the criteria on the basis of which the arbitral tribunal would be empowered to reject the parties' proposal to record their settlement in the form of an arbitral award. Objections of the arbitral tribunal should be limited to establishing that the stipulated settlement is incompatible with the public order of the legal system applicable to the arbitration.

3. AALCC is of the view that if the parties settle the dispute during the arbitral proceedings, they must be obliged to notify the arbitral tribunal, and the arbitral tribunal should terminate the proceedings only upon receipt of such notification. Paragraph (1) of article 30, therefore, needs to be amended accordingly.

Article 31. Form and contents of award

Article 31, paragraph (1)

1. The Sudan proposes adding at the end of paragraph (1) the following sentence: "However, the award shall not include any dissenting judgement".

Article 31, paragraph (4)

2. AALCC recommends that, since paragraph (1) uses the wording "the arbitrator or arbitrators", the same wording should be used in paragraph (4).

Proposed addition to article 31

3. The Sudan suggests adding the following new paragraph to article 31:

"(5) The award shall not be published except with the written consent of both parties."

Article 32. Termination of proceedings

Article 32, paragraph (2) (b)

1. Canada states that paragraph (2) (b) apparently gives the arbitral tribunal complete discretion to terminate the proceedings whenever it decides that the continuation of the proceedings becomes "unnecessary or inappropriate". It might be desirable to provide that such a decision is reviewable by the Court.

2. In the view of Yugoslavia, the grounds for the termination of arbitral proceedings specified in paragraph (2) (b) are too general and vague and may result in terminating the proceedings even where this is not in the interest of the parties. The suggestion is that an attempt be made to identify some grounds more precisely.

Article 33. Correction and interpretation of awards and additional awards

Article 33, paragraph (2)

1. AALCC is of the view that where an arbitral tribunal contemplates correcting an award on its own initiative it should be obliged to notify the parties concerned. It is therefore recommended to modify paragraph (2) accordingly.

Article 33, paragraph (3)

2. AALCC is of the view that where a party requests the arbitral tribunal to make an additional award, the arbitral tribunal should first decide on the admissibility of the request within a certain period of time, and only after it has convinced itself of the admissibility of the request should it reopen the proceedings in order to deliver an additional award. Consequently, AALCC proposes the incorporation of the following wording in paragraph (3):

"The arbitral tribunal shall decide on the admission or rejection of the request within thirty days of the receipt of such request. If the arbitral tribunal considers the request to be justified, it may initiate the necessary proceedings to deliver an additional award within sixty days."

Article 33, paragraph (5)

3. AALCC recommends the deletion in paragraph (5) of the opening words "The provisions of".

Proposed addition to article 33

4. The Sudan suggests adding the following new paragraph to article 33:

"(6) Unless the award is set aside under article 34, it has the authority of *res judicata*."

CHAPTER VII. RECOURSE AGAINST AWARD

*Article 34.**Application for setting aside as exclusive recourse against arbitral award**Article 34, paragraph (1)*

1. Canada and ICC suggest the deletion of the words "under this Law" placed between the second pair of square brackets. Canada states that it does not appear desirable to permit a court to set aside a foreign award; foreign awards should be subject to attack only under the procedure in article 36. ICC considers that it would best correspond to the practice of most countries to apply the territorial criterion and, thus, to limit the scope of the Model Law to awards made in the territory of the State that has adopted the Model Law.

2. Yugoslavia is of the opinion that in defining the scope of application of article 34, due account should be taken of the freedom of the parties to choose the law applicable to the arbitral procedure.

Article 34, paragraph (2) (a) (i)

3. Canada states that in paragraph (2) (a) (i) the phrase "failing any indication thereon" seems vague and unclear and does not appear to provide much assistance to a court which must decide to which law the parties have subjected themselves. It is suggested that the phrase and the words following it to the end of the sentence be either deleted or replaced by a clearer statement as to when the parties shall be regarded as having subjected themselves to a certain law, e.g. "... subjected it as determined by the tribunal".

Article 34, paragraph (2) (a) (iv)

4. In the view of Canada, paragraph (2) (a) (iv) covers the situation where non-observance of an agreement is in conflict with mandatory provisions of the law, but it does not appear to cover the situation where there is observance of an agreement which is in conflict with the mandatory law. The provision could be redrafted to read "... not in accordance with the agreement of the parties or with a provision of this Law from which the parties may not derogate".

5. Yugoslavia suggests that in paragraph (2) (a) (iv) a distinction should be drawn between rules whose violation always results in nullity and rules whose violation may lead to nullity; in other words, one should not accept the view that violation of every procedural rule of the applicable law should result in setting aside the award. In this context, there is again the question of the choice of law, that is, on the basis of which norms the correctness of the arbitral proceedings shall be judged for the purpose of deciding on an application for setting aside the award. If priority is given to the law of the State to which the parties subjected the arbitration, then the decision on the setting aside should be made by the Court of that State in accordance with its mandatory procedural rules.

Article 34, paragraph (2) (b)

6. The Hague Conference endorses the arguments expressed in the Working Group against the provision of paragraph (2) (b) (i).⁹ In the view of the Hague Conference, the drafters of the Model Law did not fully assess the effect of this provision. If retained, this provision would permit a party capriciously to obtain the setting aside of the award, with effect in all States, even where the subject matter of the dispute is capable of settlement by arbitration according to the law applicable to the substance of the dispute and according to the law of the place of arbitration. Such a consequence seems to be entirely unacceptable and would be contrary to the relevant general principles according to which the question of arbitrability, failing an agreement by the parties, should be decided in accordance with the law applicable to the substance of the dispute. It is, therefore, suggested that this provision be deleted.

7. In the opinion of Yugoslavia, the distinction made in paragraph (2) (b) (ii) between "the award" and "any decision contained therein" appears to be unclear, and the question is whether it is useful. Such formulation may lead to the interpretation, incompatible with contemporary trends towards restrictive interpretation of public policy, that an award could be set aside on a ground which did not influence the decision on the merits of the case.

8. The Sudan suggests adding to paragraph (2) (b) the following new subparagraph:

"(iii) the award was obtained by fraud or is based on false evidence."

Article 34, paragraph (3)

9. AALCC considers the period of time of three months to be somewhat long. However, it expresses the view that this period of time could be retained subject to the qualification "unless the parties have agreed otherwise".

Proposed addition to article 34

10. The Sudan suggests adding the following new paragraph to article 34:

"(5) The decision of the Court to set aside the award shall not be appealable but shall be subject to revision by the same Court upon application by the interested party."

CHAPTER VIII. RECOGNITION AND ENFORCEMENT OF AWARDS

ICC recommends that chapter VIII on recognition and enforcement of awards should be limited to awards made in a country that has adopted the Model Law, i.e. domestic awards, since, in principle, recognition and enforcement of foreign awards are dealt with in the 1958 New York Convention.

⁹A/CN.9/246, paras. 136 and 137.

Article 36.

Grounds for refusing recognition or enforcement

Article as a whole

1. Although suggestions have been received for some modifications to the language of article 36, Canada notes that this article closely tracks articles V and VI of the 1958 New York Convention. Understanding that the Convention works rather well, Canada feels it important that the Convention be followed even though its language has been the subject of some criticism (see, for example, *UNCITRAL's Project for a Model Law on International Commercial Arbitration*, International Council for Commercial Arbitration, Congress series no. 2, Interim Meeting Lausanne, May 9-12, 1984, General editor: Pieter Sanders, Deventer, Kluwer 1984, p. 212, para. 24, and p. 221, para. 47, concerning lack of capacity of the parties and invalidity of the agreement).

2. ICC, noting its recommendation for limiting the provisions on recognition and enforcement to domestic awards only (see the comment on chapter VIII of the Model Law), proposes that the various grounds for refusing recognition or enforcement enumerated in paragraph (1) (a) of article 36 should be deleted and that the non-existence of an arbitration agreement should be included in subparagraph (b). Thus, the possibility of double control, offered by the present text of articles 34 and 36 (1) (a), would be eliminated, since a party who opposes an award on any of the grounds referred to in present subparagraph (a) could then invoke them only in a setting aside procedure under article 34.

Article 36, paragraph (1) (a) (i)

3. The Hague Conference notes that paragraph (1) (a) (i) was taken directly from article V of the 1958 New York Convention and that it became very clear from the discussions in the Working Group that the only reason for including it in the Model Law was the existence of such provision in the 1958 New York Convention. The Hague Conference points out that it is known that this provision has been criticized and that it has not provided satisfaction. To subject the question of the validity of the arbitration agreement, failing agreement by the parties, to the law of the country where the award was made no longer corresponds to the trend in the majority of national systems of private international law towards subjecting the validity of the arbitration agreement to the law governing the main contract. It would be regrettable if the Model Law would maintain the system of the 1958 New York Convention, which has been considered not to be satisfactory. The Hague Conference suggests, so as to avoid adopting a wording which would be contrary to the one of the 1958 New York Convention, adopting a neutral provision broadly based on the new French Law on arbitration (Decree of 12 May 1981). The wording could be the following: "... or the said agreement is not valid".

C. Comments on additional points

Counter-claim

1. In the opinion of Canada, article 23 or another article of the Model Law should provide for counter-claims and replies thereto.

Secrecy of deliberations by arbitral tribunal

2. In the view of Canada, consideration should be given to providing in the Model Law that from the time the inquiry by the arbitral tribunal is complete until the time the arbitration is terminated by a final award or otherwise, the arbitral tribunal should keep its deliberations secret and not discuss the arbitration with either party *ex parte*.

Liability of arbitrators

3. In the view of Canada, consideration should be given to providing in the Model Law that a member of an arbitral tribunal should not be subjected to civil liability by reason of any action taken in good faith by him in the exercise of his function.

Costs of arbitral proceedings

4. In the view of Canada, consideration should be given to including in the Model Law a provision on costs, including the costs of interim proceedings in the arbitration.

5. The Sudan advocates adding the following new paragraph to article 32:

"(4) The costs of arbitration shall, in general, be borne by the unsuccessful party. The arbitrators may, however, apportion the costs between the parties, and such costs shall form part of the award."

6. AALCC draws the attention of the Commission to the utmost importance of costs in the matter of international commercial arbitration and proposes providing in the official commentary, which AALCC suggests should be prepared (see paragraph 7, below), an explanation for the lack of a provision in the Model Law on costs.

Commentary on the model law

7. AALCC is of the view that the Commission's Secretariat should be requested to prepare an official commentary on the Model Law on international commercial arbitration, with a view to assisting the developing countries in the uniform application and interpretation of the different provisions of the Model Law.

[A/CN.9/263/Add.2]

ADDENDUM

Introduction

1. This addendum to document A/CN.9/263 contains comments of the United Kingdom of Great Britain and

Northern Ireland on the draft text of a model law on international commercial arbitration. Since these comments are of a basic character and often relate to more than one issue or article, they are reproduced here in the order in which they were submitted.

Some comments by the United Kingdom

General observations on the draft text

2. The United Kingdom has consistently supported the project for the establishment of a model law and after extensive consultation on the draft prepared by the Working Group this attitude remains unchanged. For those States which already have a developed law and practice of arbitration the Model Law will provide a valuable stimulus for a reappraisal of the existing system, in the knowledge that other States will be engaged upon a similar exercise, all in the context of a single carefully formulated proposal for a harmonized law of international commercial arbitration. For those States which have not yet had the occasion to work out a comprehensive system of their own, the Model Law, with its associated commentaries, will form a most valuable basis for legislation.

3. The United Kingdom also continues to emphasize the two principles which it has sought to bring forward during the deliberations of the Working Group. First, that arbitration is a consensual procedure. The practical needs of the parties to the arbitration agreement are paramount. The only proper objective for any law of arbitration is to ensure that commercial men have their disputes decided fairly, in the manner which they have expressly or impliedly agreed, and in a manner appropriate to the nature of the dispute in question. The value of a uniform law is recognised. Nevertheless, it must be constantly borne in mind that disputes are not uniform, and that there is no single procedure which is appropriate to them all. A law of arbitration should provide no more than a supportive framework for the conduct of the arbitration in a way which conforms with the requirements of the individual case. The model law will fail in its purpose if it inhibits the flexibility and freedom of choice which is the prime advantage of arbitration.

4. The second principle is a corollary of the first. No system is perfect. There will inevitably be a minority of cases where the parties do not have the benefit of a procedure which is fair, or in accordance with their agreement. Justice demands that the injured party should have a remedy, and the court is the only medium through which the remedy can be made available. Attractive as it may be in theory to dissociate the arbitral process from judicial control, the fact remains that in practice this is an impossible aim. Wide consultation with users of the arbitral process, whose wishes and needs are paramount, has convinced the United Kingdom that the commercial man recognizes the need to have in reserve a prompt and effective means of recourse. It is for this reason, and not at all because of any doctrinaire preference for judicial control over the independence of the arbitral process, that the United Kingdom has adopted the position which it

has already made clear during the deliberations of the Working Group. Quite the reverse, for the United Kingdom wholeheartedly supports all measures which will enable that process to flourish in the manner which ensures the parties an effective performance of their agreement to arbitrate.

5. The process of consultation has inevitably brought to light several matters of detail, which can readily be raised during the meetings of the Commission. There are, however, certain issues of central importance upon which it may be helpful for the United Kingdom to express its views in writing.

Territorial scope of the law and jurisdiction of courts

6. It is necessary for the Model Law to adopt a stance on these separate but closely connected issues.

7. The issue of jurisdiction arises in this way: suppose two parties with places of business in two different States, A and B, choose to arbitrate in State B. (The model law does not at present exclude an application to the courts of State A under articles 11-14 (though it will do so if it is described to limit its scope of application in a strictly territorial way) or where the "matter" is not governed by the Model Law.) If the courts of A and B take divergent views, then a conflict of jurisdiction arises.

8. The issue of territorial scope arises in particular when two parties in two different States, C and D, which both have adopted the Model Law, choose to arbitrate in State D under the arbitration law of State C. Should the Model Law allow for its "exportation" in this manner?

9. There are, of course, two possible approaches to the latter issue:

(a) To allow the parties to choose the arbitration law of another State adopting it. The effect of article 6 of the Model Law would mean, in the example given above, that the courts of State D will be deprived of any jurisdiction over the arbitration taking place within that State's territory. This is because the chosen curial law will give exclusive jurisdiction to the courts of State C. This may be termed the "extraterritorial approach".

(b) To specify that the Model Law applies only to arbitrations within the territory of the State adopting it, regardless of the choice of a foreign curial law of the parties. This deprives the parties of their freedom of choice, but ensures that the court of the arbitral forum has jurisdiction in all cases and since the Model Law is not "exportable" then, in the example given above, the courts of State D will have *exclusive* jurisdiction only in respect of arbitrations taking place within their territory.

10. A third approach, allowing the choice of a foreign curial law but giving the courts of the arbitral forum a concurrent jurisdiction, is precluded by the structure of the draft and in particular article 6. The other possibility, again like the third separating the issue of territorial scope from the question of court jurisdiction, is to allow the

parties to choose the foreign curial law but override the resulting choice of the foreign court—but *a fortiori* this is precluded by the draft as presently worded.

11. The United Kingdom prefers a territorial approach: the Model Law should apply only to arbitrations within the territory of the State adopting it whose courts should have exclusive jurisdiction over the arbitral proceedings and recourse actions under article 34. It would be unacceptable to have the jurisdiction of the local court completely ousted in respect of arbitrations taking place within its territory. Difficulties will also arise under article 36 (1) (a) (iv) (and also under the New York Convention) if the foreign procedural law differs from that of the arbitral forum. The courts of the arbitral forum are the most logical choice as the courts of recourse—they are best placed to enforce any orders made, are convenient for the parties and may be taken to be their choice (especially under a "territorial" model law).

12. Difficulties do however arise where, in the example given above, State C has adopted the law but State D has not. Under the territorial approach the Model Law is not exportable and the courts of C can only control arbitrations within the territory of C (as a result of article 6). The courts of State D may not have jurisdiction under their own law because the parties have chosen another. This problem may be more academic than real. Only if the question of jurisdiction is separated from that of territorial scope can it be dealt with in a satisfactory manner.

Articles 34 and 36

13. Although the "Analytical compilation of comments by Governments and international organizations" (A/CN.9/263 and Add.1) contains nothing to suggest any opposition to the continued inclusion of article 34 in the Model Law, the matter was the subject of some debate during meetings of the Working Group. The United Kingdom thinks it appropriate briefly to restate its position on the matter. Two points are made.

14. First, the United Kingdom regards it as essential that the right to intervene in the case of procedural injustice should not be confined to the stage of execution. To do so would ignore the important effect of an award before any attempt is made to enforce it. One may postulate a situation where the proceedings were subject to a defect which beyond any doubt would enable the defendant to resist execution under article 36 or the New York Convention. If article 34 were excluded, the defendant would be powerless to put forward his complaint until at a time and place of his own choosing the claimant instituted proceedings for execution: a choice determined not by any connection between the arbitration or the subject-matter of the arbitration and the chosen place, but by where the defendant happened to have any assets available for execution. Meanwhile, the award would to all appearances be valid, and would make the issues between the parties *res judicata*. True it is, that the defendant could decline to pay the amount awarded,

but to dishonour an award is a step which a respectable businessman would take with the utmost reluctance, and which might cause grave damage to his commercial reputation. The defendant, if a company, would have to make provision for the unsatisfied award in its balance sheet, and if it was of any size it would be likely to have an adverse effect on the availability of credit. All this would produce a serious injustice, and it is no recompense to the defendant to say that at some unknown time and place he will be able to vindicate his dishonouring of the award by successfully resisting enforcement. What is required is an opportunity for the defendant to intervene promptly, so that he can free himself from the burden of an award which should not have been made.

15. Secondly, the United Kingdom submits that article 36 or the New York Convention, which it closely follows would not if they stood alone provide an adequate protection to the defendant from the consequences of a procedural injustice. The grounds set out in the Convention were undoubtedly formulated on the assumption that before the award is brought forward for execution, there will already have been an opportunity for the defendant to have recourse against the award in the local court. (This is indeed made explicit by article 36 (1) (a) (iv).) If this assumption were to be falsified by the exclusion of article 34, and the consequent abolition of any active right of recourse against the award, the list of grounds set out in the Convention and article 36 would give the defendant only part of the protection which was envisaged when the list was drawn up.

The form of the arbitration agreement

16. Article 7 (2), in requiring a document signed by the parties or an exchange of letters or telecommunications recorded in a tangible form, is not sufficient to encompass trade practice. A number of valid arbitration agreements are evidenced in documents not signed by the parties. Perhaps the most important of these are bills of lading. The United Kingdom prefers the approach adopted in article 17 of the Brussels Convention of 1968 on Jurisdiction and the Enforcement of Judgments, as amended, which refers to agreements which are "in writing or, in international trade or commerce, in a form which accords with practices in that trade or commerce of which the parties are or ought to have been aware".

The jurisdiction of the arbitrator

17. The United Kingdom attaches great importance to the reintroduction into the text of the previous article 17. Without it, an incorrect ruling by an arbitrator in favour of his having jurisdiction can only be challenged in an action for setting aside under article 34. By the time the award has been made the parties will have been put to a great deal of expense, and to have to litigate the matter further will cause considerable delay. Instead of preventing dilatory tactics by a defendant,

the deletion of article 17 provides for them. Sufficient safeguard against abuse of article 17 was contained in article 17 (2), which allowed the arbitration proceedings to continue during the challenge before the court (except where the court ruled otherwise—which it would no doubt refrain from doing save in a clear case). A discretionary power for the tribunal to make an interim award is not a sufficient protection for the parties.

A right to a hearing

18. As to article 24, the United Kingdom wishes to endorse the view expressed by the Secretariat in its commentary (A/CN.9/264, commentary to article 24, para. 4). In the absence of agreement between the parties, one party should have the right to require that oral hearings should be held. The present text appears to be in conflict with articles 19 (3) and 34 (2) (a) (ii).

Judicial intervention: article 5

19. Although article 5 was introduced at a comparatively late stage in the deliberations of the Working Group, it has rightly been regarded as a valuable attempt to reflect the philosophy underlying the Model Law. The United Kingdom recognizes the desirability of a clear statement which will enable the draftsman of any resulting legislation, and any party to an arbitration conducted under such legislation, to know whether or not in any given situation recourse to the court is permissible. Accordingly, no objection is taken to the introduction of a provision on the lines of article 5. It is, however, suggested that important aspects of the article remain to be thoroughly explored, before the form of the article can be finalized. Four questions are raised for consideration:

- (a) What matters are "governed by the Model Law"?
- (b) At what stages of the arbitral process does the Model Law permit the court to intervene?
- (c) In what circumstances may a court properly intervene when it is proved that the award is the result of a procedural injustice?
- (d) Should the parties be enabled to vary by consent the incidence of judicial intervention?

What matters are governed by the Model Law?

20. The general intent of article 5 has been explained by those responsible for introducing it as follows: The model law does not embody a complete code of judicial intervention. The model law is addressed only to certain types of situations in which the question of judicial intervention may arise. Where a party seeks judicial intervention in one of those situations, the court is permitted to intervene only in the manner expressly prescribed by the Model Law, and in the absence of any express provision the court must not intervene at all. By contrast, where the situation is not of a type to which

the Model Law is addressed, the court may intervene or decline to intervene in accordance with the provisions of the relevant domestic arbitration law.

21. While the general intent is well understood, the United Kingdom feels obliged to observe that there are objections to the present form of article 5 which could make it unworkable in practice. The problem may be illustrated as follows. Assume that a factual situation "X" developed in the course of an arbitration, and that the situation causes one of the parties to seek the intervention of the court. Plainly, the court must ask itself whether it has jurisdiction to intervene. The first step is to see whether the situation is covered by the express words of the Model Law. (Strictly speaking, the words in question will be those of the domestic legislation enacting the Model Law, but for brevity we shall continue to refer to the Model Law.) If the court finds that there are words which cover the situation, it need look no further. The remedies prescribed for that situation, and no others, may properly be applied. But what if the court finds that the situation is not covered by any express words? The court could surmise that there might be any one of three reasons for this omission:

- (a) Those who framed the Model Law had considered situation X and had decided that the situation should not be dealt with by the Model Law;
- (b) Those who framed the Model Law had considered situation X and had decided that there should be no power of judicial intervention in that situation;
- (c) Those who framed the Model Law had not considered situation X at all.

22. The court will then be faced with three problems. First, how is the court to know which of these alternatives provides the true explanation for the failure to mention situation X? Recourse to the *travaux préparatoires* will not necessarily provide the answer. The commentaries cannot, in the nature of things, record every aspect of the debates in the Working Group and the Commission. Moreover, the list of subjects not intended to be governed by the Model Law, which can be found in document A/CN.9/246 (para. 188) and document A/CN.9/264 (commentary to article 1, para. 8, and to article 5, para. 5), is plainly given for illustration only.

23. The second problem will arise if the court finds that situation X can be said to be of the same general type as situations which are expressly dealt with by the Model Law. The United Kingdom believes that the framers of article 5 might answer that all situations of that type are "governed by" the Model Law, and that the absence of any reference to situation X shows that the framers of the Model Law intended that the court should have no power to intervene in that situation. While the United Kingdom sees the force of this in principle, it can envisage serious procedural difficulties in deciding whether or not a situation is of a type dealt with by the Model Law. Is one to consider whether situation X would, if it had been specifically dealt with in the Model Law, have fallen within one of the

individual chapters? If so, this is to attribute great weight to what is only a matter of arrangement, and which has never been fully debated. The article headings cannot be relied upon to establish the "type" (see the footnote to article 1). The United Kingdom is not at present clear in what way the court is to know whether situation X is close enough to other situations expressly dealt with in the Model Law to entail that it is governed by the Model Law.

24. (In this respect it may be helpful to draw attention to the description of the principle of article 5 contained in para. 4 of the commentary on that article 5 in A/CN.9/264, where it is stated that the article "is limited to those issues which are in fact regulated, whether expressly or impliedly, in the Model Law". The crucial words here are "or impliedly". The United Kingdom submits that the Commission could usefully discuss the meaning of these words, and consider whether there is any way in which that meaning could be embodied in the text of the law itself.)

25. The third problem will arise if the situation in question is one which the framers of the Model Law had never considered at all. In para. 188 of A/CN.9/246, it is stated that article 5 would not exclude court control or assistance in those matters "which the Working Group had decided not to deal with in the law". This would seem to suggest that in situations not foreseen by the Working Group, where accordingly the Working Group did not decide anything about them, article 5 *does* operate to exclude judicial control. Is this really the intention of the Model Law?

26. The United Kingdom wishes to emphasise that these are not theoretical objections raised out of hostility to the principle of article 5, but reflect genuine uncertainties expressed by those users of the arbitral process consulted by the Government of the United Kingdom as a preliminary to the meeting of the Commission. It is of particular importance that these uncertainties should be resolved because, quite apart from the position of any court confronted with a request to intervene in a case not expressly dealt with in the Model Law, any legislature contemplating the enactment of the Model Law would need to have a clear idea of the extent to which the law would affect the existing rules, whether statutory or otherwise, governing judicial intervention.

The stage at which judicial control is permissible

27. This problem may be dealt with more briefly. Circumstances may arise during the reference in which the arbitration is being conducted in a manner which is an abuse of the defendant's rights, and which the arbitrators cannot or will not correct. In such circumstances, it would appear proper that the court, as being the only body in a position to protect the defendant, should have a residual power to intervene. Is it the intention that this power should entirely be taken away?

28. This question illustrates the problems previously discussed. The model law does contain, in articles 9 and

27, provisions enabling the court to give supportive assistance during the reference; and articles 11, 14 and 15 give the court a limited role in relation to the constitution and reconstitution of the arbitral tribunal. These are, however, powers of a quite different kind from those now under discussion. Moreover, although article 34 confers certain powers to intervene where the reference has been conducted in contravention of the defendant's rights, these are only to be exercised by recourse against the award. The model law therefore does not deal with recourse during the reference. Does this mean that such recourse is not "governed by" the Model Law and is therefore not within the scope of article 5?

Intervention on the ground of procedural injustice

29. The United Kingdom attaches great importance to a correct understanding of the rights of recourse against the award under article 34 (2) in cases where it is proved that the award has resulted from serious procedural injustice. It is possible that some misunderstanding has arisen during the discussion of this topic during the meetings of the Working Group.

30. In the course of those discussions it was suggested by the United Kingdom that it would be desirable to give the court a general discretion to intervene in such a case, by reference to some words such as "misconduct", because of the difficulty in defining the jurisdiction in specific terms without the risk of inadvertently excluding the right to intervene in cases where it is obviously required. Objection was taken to this suggestion on the ground that it lacked precision, and the weight of adverse opinion was such that the United Kingdom does not intend to pursue it. Nevertheless, it remains important to be clear whether: (a) (as was suggested on several occasions during the meetings of the Working Group) the Model Law already confers a right of recourse in respect of *all* serious procedural injustice, or (b) the Model Law intentionally withholds a right of recourse in certain of such cases.

31. If the Commission concludes that interpretation (a) is correct, the United Kingdom would not seek to promote any amendment to the relevant provision of the draft, since (so understood) it would confer all the desired protection. The United Kingdom does, however, draw attention to the way in which the Model Law defines the circumstances in which intervention is permissible:

Article 34 (2) (a) (ii)

"... the party making the application was not given proper notice ... of the arbitral proceedings or was otherwise unable to present his case";

Article 34 (2) (a) (iv) read with Article 19 (3)

"... the arbitral procedure ... was not in accordance with this Law ..."

"... the parties shall be treated with equality and each party shall be given a full opportunity of presenting his case ..."

Article 34 (b) (ii)

"... the award or any decision contained therein is in conflict with the public policy of this State."

32. In order to assist in the consideration of this question, the United Kingdom suggests the following examples. In all cases it may be assumed that the parties received sufficient notice of the proceedings; that the procedures followed the course demanded by the express provisions of the arbitration agreement, and of the procedures laid down by the arbitral tribunal, and that the tribunal placed no obstacle in the way of the parties in the full presentation of their documents, witnesses and arguments.

(a) The award is founded on evidence which is proved or admitted to have been perjured;

(b) The award was obtained by corruption of the arbitrator or of the witnesses of the losing party;

(c) The award is subject to a mistake, admitted by the arbitrator, of a type which does not fall within article 33 (1) (a);

(d) Fresh evidence has been discovered which could not have been discovered by the exercise of due diligence during the reference. The evidence demonstrates that through no fault on the part of the arbitrator the award is fundamentally wrong.

33. The United Kingdom ventures to doubt whether these situations (which are only instances of the various ways, not fully predictable in advance, in which an arbitration may go wrong) fall within any of the provisions quoted above, *unless* they fall to be dealt with as contraventions of public policy. The structure of English arbitration law is such that there has been no need to create any doctrine of public policy in relation to instances such as those stated above: the express statutory power to intervene is sufficient. The United Kingdom is not in a position to say how "public policy" would be understood in the courts of other States, but the decisions referred to in *Van den Berg* "The New York Arbitration Convention of 1958" at pp. 359 *et seq.* would appear to suggest that these words are not in general widely construed. If this continues to be the approach, there will be a risk that an injured party will be powerless to protect himself, even in the case of serious procedural injustice.

34. The comments just made have been expressed in terms of article 34. They apply also to Article 36, with this added feature that article 19 (3) will not be a ground for intervention unless the law of the country where the arbitration took place incorporated the Model Law: contrast article 36 (1) (a) (iv) with article 34 (2) (a) (iv).

35. In relation to the questions raised under this heading, the United Kingdom draws attention to article 52 of the Convention on the Settlement of Investment Disputes (Washington 1965) for an example of a more explicit approach to recourse in the event of serious procedural injustice.

The consent of the parties in relation to judicial control

36. It has repeatedly been emphasized that the basic principle of the Model Law is that of "party autonomy". Arbitration is a consensual process, and the health of the process is best ensured by enabling commercial men to have their arbitrations conducted in whatever way they have agreed to be suitable, subject only to certain exceptions designed to ensure that the courts of a State are not required to countenance procedures and awards in circumstances which render them objectionable. The United Kingdom wholeheartedly supports this approach.

37. The question therefore arises whether and to what extent the principle of party autonomy should be applied in the field of judicial control. It is believed to be universally accepted that there must at some stage be some degree of judicial control, although there may be differences as to the appropriate stage and the appropriate degree. Thus the Model Law must set a *minimum* of judicial control. It does not follow, however, that the Model Law should set a *maximum*, eliminating even those means of judicial control which the parties themselves desire to retain. Would not the principle of party autonomy demand that if the parties have agreed to avail themselves of measures available under the local law, the court should be able to give effect to their agreement?

38. The United Kingdom has raised this question because the recent consultations on the draft of the Model Law had disclosed a substantial (although of course far from unanimous) body of opinion amongst the businessmen who use the arbitral process in the United Kingdom which favours retaining a possibility of recourse to the court on questions of law. Whilst thoroughly understanding the point of view undoubtedly held by the majority of participants in the Working Group—that the parties should not be *compelled* to submit to recourse on questions of law—the United Kingdom suggests that the logical consequence of party autonomy is that they should be *allowed* to have recourse, if that is what they have agreed. The same conclusion applies to other measures of judicial assistance to the arbitral process, also excluded by the draft model law. The United Kingdom invites a reconsideration of the mandatory nature of article 5.

[A/CN.9/263/Add.3]

ADDENDUM

This addendum to document A/CN.9/263 contains the comments of Egypt on the draft text of a model law on international commercial arbitration.* Since these comments are of a basic character and often relate to more than one issue or article, they are reproduced here in the order in which they were submitted.

*These comments were received in the secretariat on 29 May 1985. As it was not possible to translate them into the other five official languages of the United Nations in time for the session, they were distributed to the participants of the eighteenth session in their original French version. They are now published as a post-session document in order to complete the records of documents submitted to the Commission in the course of consideration of the draft Model Law.

Comments of Egypt on the draft model law on international commercial arbitration

Introduction

1. Egypt presents its compliments and congratulations to the Chairman of the Working Group on International Contract Practices, to the members of the Group and the Secretariat of the Commission for the thorough and valuable work which they have carried out in preparing the draft model law on international commercial arbitration. Egypt also wishes to express its satisfaction with regard to the draft as a whole and hopes that the present session of the Commission will not end without its adoption.

2. Having set up an arbitration centre in Cairo under the auspices of the Afro-Asian Legal Consultative Committee, Egypt feels it to be an opportune moment to revise its legislation on commercial arbitration, which has proved, particularly at the international level, to be inadequate and incomplete. Egypt is therefore particularly interested in the draft law under consideration and it believes that this interest is shared by several other countries which, like Egypt, envisage adopting commercial arbitration laws better adapted to the needs of international practice. Without waiting for the final adoption of the draft, the Cairo Arbitration Centre has already set up a working group to study the draft and to consider its introduction into the planned new Egyptian legislation. When this legislation comes into effect, the Cairo Centre, which has already adopted the UNCITRAL Arbitration Rules, will be an effective arbitral body for the region founded on a complete and universally recognized package of legal rules.

3. While approving the draft model law as a whole, Egypt would like, however, to submit certain comments on the draft to the Commission, some of them being of a general nature and others relating to specific articles.

General comments

The model law and national arbitration

4. In conformity with the objectives of the body initiating it, the draft is only concerned with the interests of international commerce, putting forward a model law on arbitration which is likely to be accepted by a large majority of countries and thus achieving a certain standardization of the law on this subject. It is therefore restricted to international commercial arbitration without concerning itself with the fact that any State adopting it would have two laws in its legislation (both of them national), one governing so-called national arbitration which does not fall within the definition of "international" set out in article 1 paragraph 2, and the other concerning international arbitration as defined in that paragraph. Now it would not be unusual for a State wishing to avoid this duplication to prefer to extend the scope of the Model Law by incorporating

both categories of arbitration within its provisions. A State taking this course would be faced with difficulties which it could only overcome by introducing amendments into the Model Law which could lead to disparity between legislations and conflicts of laws. Egypt particularly has in mind the provisions of the Model Law relating to public policy in certain States, such as, for example, the non-statement of reasons for the arbitral judgement, the unlimited right of the parties to authorize the arbitrator to make a judgement *ex aequo et bono*, the non-requirement for an odd number of arbitrators and the restriction of the jurisdiction of the courts over the arbitral proceedings. These exceptions to the requirements of public policy could, in a spirit of internationalism, be tolerated by the State as regards external relations, but at the national level the State is more sensitive with regard to its public policy requirements. There lies the problem for a State wishing to combine the two categories of arbitration under the umbrella of the Model Law. The problem has not been studied by the Working Group. At this late stage Egypt will confine itself to drawing attention to it without suggesting that the Commission should consider it, since there would be objections that this is a particular problem which each State concerned will resolve in its own fashion. Nevertheless, it also constitutes a breach which could admit disparities in national legislations and thus might threaten the work of standardization.

The model law and the 1958 New York Convention

5. The last chapter of the Model Law, which comprises the two articles 35 and 36, deals with recognition and enforcement of arbitral awards. Article 35, paragraph 1 obliges a State adopting the Model Law to recognize and enforce the arbitral award subject to certain conditions set out in paragraphs 2 and 3 of the same article. Article 36 provides an exhaustive list of grounds for refusing recognition or enforcement.

6. It is well known that there is an international convention on this matter (the 1958 New York Convention) which is universally recognized as effective. States which have already ratified or acceded to this Convention will not need articles 35 and 36 of the Model Law, for these articles would constitute a pointless duplication within their legislation. Given the success of the New York Convention, it is most likely that articles 35 and 36 will be of value only to a minority of States which will also ultimately adopt the Convention and thus join the system recognized by the majority of the members of the international family. For this reason Egypt believes that little would be lost if the Model Law stopped at article 34.

7. If it is suggested in support of the retention of articles 35 and 36 that certain provisions of the Convention have defects or ambiguities, the remedy would appear to lie not in the creation of a duplication, which might cause confusion, but in a call by the Commission for a review of the Convention, followed by a thorough study of the proposed reform.

"Commercial" and "international"

8. With regard to the term "commercial", Egypt, although among those countries which make a distinction between commercial and non-commercial persons and between commercial and civil acts, is in favour of the content of the text of the note relating to article 1, paragraph 1, for it proposes an acceptable compromise on this subject between the different juridical systems. Although Egypt is fundamentally in agreement, it would have difficulty, however, in including such a note in the Model Law when it adopts it, for it is not customary in Egyptian legislation to include notes on the texts of laws or to cite examples as an aid to their interpretation. Egypt therefore proposes that a definition of the term "commercial" reproducing the content of the note without the examples referred to should be inserted in article 2. Of course, these examples would be useful in clarifying the too general terms of the proposed definition, but such clarification would be better placed in a commentary on the Model Law or in an accompanying explanatory note.

9. With regard to the term "international", Egypt is in favour of the system suggested in article 1, paragraph 2, which sets out in subparagraph (a) a general criterion and adds in subparagraph (b) other situations which tend to ease the rigidity of the general criterion and thus extend the scope of the concept of "international". In Egypt's view, this system is a reasonable compromise between those extreme opinions which tend towards an excessive extension or restriction of the scope of the Model Law.

Territorial scope

10. Without prejudging the result of the debate which will take place in the Commission on the problem of territoriality or extraterritoriality of the Model Law which the Working Group left for its consideration, Egypt would like to clarify its position on two questions related to this problem.

11. The first question concerns the freedom of the parties to choose the rules of procedure governing their arbitration. Whatever the result of the debate which takes place in the Commission on this problem, Egypt insists that this freedom should be respected. Apart from rules aimed at protecting justice, Egypt would be opposed to any solution restricting this freedom, whether by obliging parties to apply the rules of procedure of the place of arbitration or by limiting their right to seek rules of procedure in other sources of their choice (for example, a foreign law, an arbitration rule or even their own will).

12. The second question relates to article 34 concerning the problem of territorial scope through the two phrases of paragraph 1 which are left in brackets. Speaking of the application for setting aside the arbitral award, this text, in order to be acceptable, proposes that the award should be made "in the territory of this State" (territoriality) "under this Law" (extraterritoriality) and leaves the Commission to decide whether

the two expressions should be retained, deleted or only one of them deleted.

13. In this respect, Egypt is in favour of territoriality, that is, the retention of the expression "in the territory of this State" and the deletion of the other expression "under this Law". The latter expression could, indeed, have the effect of giving national courts authority to rule on the validity or nullity of an award given outside their territory. This extraterritorial jurisdiction would not be acceptable to several countries unless there were reciprocity.

14. In this connection Egypt would like to add that it is in favour of the insertion in article 2 of a general definition of the arbitral award. In the event of this definition proving difficult to formulate, the Commission could simply specify in article 34 what kinds of awards might be set aside under this article, for it is in this context that the definition seems most useful.

Coexistence of articles 34 and 36

15. Egypt has already given the reasons why it prefers to see the Model Law stopping at article 34, relating to an application for setting aside the arbitral award, without becoming concerned, as occurs in articles 35 and 36, with the problem of recognition and enforcement of the award, which is governed by other international texts, particularly the 1958 New York Convention.

16. But this is no more than a simple suggestion which will probably be rejected by the Commission, in which case the two problems of setting aside and recognition will be juxtaposed within the Model Law. As far as Egypt is aware, this would be the first time that an international text contained the two problems side by side: the 1958 New York Convention only covers recognition and enforcement, while the 1961 European Convention—whose aim is broader—ignores this problem and deals only with setting aside.

17. The model law, in wishing to take account of both these problems, naturally seeks to be complete and independent. While this objective is commendable in itself, the coexistence of two texts establishing two means of attacking the award based on the same grounds may cause confusion. To take two examples:

(a) Where the court defined in article 6 as authorized to hear the application for setting aside decides to set aside the award, there will be no difficulty; the award is annulled. It will not be recognized or enforced in any country which has adopted the Model Law. But what would the situation be in the contrary hypothesis, where the court refused the application for setting aside? Could the award then be challenged before the competent authority responsible for hearing the application for recognition and enforcement on the same grounds as those of the application for setting aside which was refused?

(b) Article 34 speaks of a time limit for making the application for setting aside (three months). Article 36, on the other hand, imposes no time limit on the submission of an application for enforcement, which enables the party time-barred from the right of making an application for setting aside to stage a last-minute come-back and challenge the award at the stage of the application for enforcement. What, therefore, is the value of the time limit in article 34 if it cannot protect the award against late challenges?

18. The co-existence of articles 34 and 36 becomes more unfortunate when the matter in question is the validity or nullity of the arbitration agreement, for in that case two other articles (article 8 and article 16) are involved, giving rise to further complications. For example:

19. In a contract of sale concluded between an Egyptian enterprise and a Lebanese merchant, there is an arbitration clause providing for arbitration in Egypt. As a result of a dispute between the two parties, the Lebanese merchant, claiming that the subject of the litigation does not fall within the provisions of the arbitration clause, initiates an action before the competent court in Lebanon. The Egyptian party, maintaining the contrary view, requests the referral of the matter to arbitration in Egypt. The Lebanese party objects that there is no arbitration agreement covering the subject of the litigation. This brings us to article 8:

(a) The Lebanese court refers the case to arbitration, which implies its recognition of the existence, validity and effectiveness of the arbitration agreement;

(b) Before the arbitral tribunal in Egypt, the Lebanese party raises an objection of lack of competence based on the same reasoning, that is, the lack of an arbitration agreement. This is dealt with by article 16, which does not forbid the repetition of the objection on the same grounds;

(c) The arbitral tribunal rules in favour of the Egyptian party, on the substance and on the objection. By rejecting the objection of lack of competence it at the same time recognizes the existence, validity and effectiveness of the arbitration agreement;

(d) Within the period of three months the Lebanese party submits to the court specified in article 6 in Egypt an application for setting aside of the award based on the same grounds. This is under article 34, where there is nothing to prevent this recourse;

(e) The court specified in article 6 refuses the application for setting aside, which means that it too recognizes, and for the third time, the existence, validity and effectiveness of the arbitration agreement;

(f) The Egyptian party then goes to the Lebanese authority empowered with the granting of the exequatur but there runs up against an objection by the Lebanese party, who for the fourth time invokes the non-existence of the arbitration agreement. We are now at article 36, which likewise contains no bar to such an application when the court specified in article 6 rules in favour of the existence or validity of the arbitration agreement.

20. This example demonstrates the extent to which there is a lack of co-ordination between four provisions contained within the Model Law and dealing with the same problem. Each of them has an independent life of its own without there being any link between them which might combine them in a defined system.

Comments on the articles

Article 4

21. Egypt approves this article, substance and form. The text has the merit of correcting the rigour of the presumption which it establishes by giving the judge discretion with respect to the component elements.

Article 5

22. Although it touches on a delicate matter, control of arbitration by the courts, Egypt is in favour of retaining this article, for by limiting this control to instances provided by the Model Law, it brings order to the disparity of national legislations on this subject and frees the arbitral proceedings from a yoke which, in some legislations, is too burdensome.

23. Egypt also approves the restriction of the scope of article 5 to the matters regulated by the Model Law, because the exclusion of other questions, particularly those deleted by the Working Group, sets a balance which may help to assuage the sensitivity of some States in this area.

Article 6

24. Comment on the form: instead of referring to the numbers of articles and paragraphs relating to the functions of the court in question, Egypt proposes the use of a general formula such as: "The court competent to undertake the functions set out in this Law is . . .". It should be noted that the form "in this Law" has been used on many occasions.

Article 8

25. Paragraph 1 seems acceptable to Egypt. Egypt shares the view that its scope should not exceed the two principles which it expresses, namely denying the court the power to refer to arbitration on its own initiative and the inadmissibility of the application for referral beyond the time limit provided in the text.

26. With regard to paragraph 2, Egypt proposes the reinsertion at the end of this paragraph of the phrase "unless the court orders a stay of the arbitral proceedings", which was in the original text and was deleted by the Working Group. In Egypt's view, it would be useful to give the court a power of ordering the suspension of arbitral proceedings when it believes that the setting aside or annulment of the arbitration agreement is the most likely outcome. Such a measure would save time, effort and expense.

Article 13, paragraph 3

27. This paragraph allows the arbitral tribunal, where the challenged application is before the court specified in article 6, to continue with the arbitral proceedings. Egypt believes it is preferable also to grant the tribunal the power to order the suspension of the proceedings whenever it is aware of the existence of grounds to justify such a step.

28. If this proposal is accepted by the Commission, the last phrase of paragraph 3 should be drafted as follows:

"... while such a request is pending, the arbitral tribunal, including the challenged arbitrator, may continue the arbitral proceedings, unless the tribunal orders their suspension."

*Article 22, paragraph 3**

29. Amend this paragraph as follows:

"The arbitral tribunal may order that any documentary evidence shall be accompanied by a translation into the language, languages or one of the languages agreed upon by the parties or determined by the arbitral tribunal."

30. The proposal adds the term "one of the languages" with a view to saving time and money. The fact that the parties or the tribunal have chosen several languages for use in the arbitral proceedings shows that the use of any one of them would not prejudice the positions of the parties.

31. It should be noted that the proposal retains the word "languages" alongside the proposed term "one of the languages" in order to allow the arbitral tribunal a wider power of discretion. It could thus require translation into all the agreed languages if circumstances made this advisable.

Article 27

32. Egypt holds the view that the scope of this article should be restricted to arbitral proceedings undertaken within the State. It seems to Egypt excessive to oblige a State to grant the benefit of assistance in the event of arbitral proceedings taking place outside its territory.

Article 28

33. Proposal: Amend paragraph 2 as follows:

"Failing any designation by the parties, the arbitral tribunal shall apply the substantive law which it considers applicable."

*Note by Translation Section: in the draft law there is no "paragraph 3"; and "paragraph 2" is presumably meant.

34. Commentary: Article 28, paragraph 1 gives the parties the unrestricted right to choose the law applicable to the substance of their dispute. It even establishes a presumption that any designation of a law of a given State is considered, unless otherwise expressed, as directly designating the substantive law and not the conflict of laws rules.

35. Failing a designation by the parties, paragraph 2 entrusts the arbitral tribunal with the designation. But instead of giving it the right to designate the substantive law directly, as paragraph 1 does for the parties, it only gives it the choice of law whose conflict of laws rules will be used to designate the applicable substantive law.

36. This distinction between the two situations seems to us to be untenable. It is a relic of a misguided sense of distrust of the institution of arbitration, a distrust which is outdated and which practical experience has already discredited. Egypt's proposal aims at removing this distinction.

Article 32, paragraph 2, subparagraph (b)

37. The text states that where the arbitral proceedings become unnecessary or inappropriate, the arbitral tribunal "may" order the termination of the proceedings. The word "may" indicates a right and not an obligation. Consequently, despite a conviction that the proceedings have become unnecessary or inappropriate, the arbitral tribunal may, nevertheless, order their continuation. On what grounds? To what purpose? In whose interest? The text does not state. It is clear that the continuation of such proceedings would be nothing more than a waste of time, effort and money. Egypt therefore proposes that paragraph 2 be amended as follows:

"(2) The arbitral tribunal shall issue an order for the termination of the arbitral proceedings when:

"(a) the claimant withdraws ... (no change);

"(b) the arbitral proceedings become, for any other reason, unnecessary or inappropriate."

Article 34, paragraph 2, subparagraph (b) (i)

38. Egypt supports the view that this text should be deleted. The grounds for this deletion were put forward and discussed in the Working Group and will not be repeated here. Egypt merely adds that the proposed deletion does not imply the exclusion of non-arbitrability as a ground for setting aside, as this setting aside would be covered by other texts: by subparagraph (b) (ii) when the arbitrability is a matter of the public policy of the State, and by subparagraph (a) (i) when it is considered by the law of the State as an element of the arbitration agreement.

B. Analytical commentary on draft text of a model law on international commercial arbitration: report of the Secretary-General (A/CN.9/264)^a

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^aFor consideration by the Commission, see *Report*, chapter II, A (part one, A, above).

Introduction

1. The United Nations Commission on International Trade Law, at its fourteenth session, decided to entrust its Working Group on International Contract Practices with the task of preparing a draft model law on international commercial arbitration.¹ The Commission, at that session, had before it a report of the Secretary-General entitled "Possible features of a model law on international commercial arbitration" (A/CN.9/207). It was agreed that this report, setting forth the concerns and purposes underlying the project and the possible contents of a model law, would provide a useful basis for the preparation of such a law.²

2. The Working Group commenced its work, at its third session, by discussing a series of questions designed to establish the basic features of a draft model law.³ At its fourth session, it considered draft articles prepared by the secretariat⁴ and reviewed, at its fifth and sixth sessions, redrafted and revised articles of a model law.⁵ The Working Group, at its seventh session, considered a composite draft text and, after a drafting group had established corresponding language versions in the six languages of the Commission, adopted the draft text of a model law as annexed to its report.⁶

3. The Commission, at its seventeenth session, requested the Secretary-General to transmit this draft text of a model law on international commercial arbitration to all Governments and interested international organizations for their comments and requested the secretariat to prepare an analytical compilation of the comments.⁷ It also decided to consider, at its eighteenth session, the draft text in the light of these comments, with a view to finalizing and adopting the text of a model law on international commercial arbitration.⁸

4. At the seventeenth session, a suggestion was made that the secretariat should prepare a commentary on the draft Model Law which would assist Governments in preparing their comments on the draft text and later in their consideration as to any legislative action based on the Model Law. The Commission was of the view that such a commentary, although it could not be prepared in time to be of assistance to Governments in preparing their comments, would be useful if it were made available at the eighteenth session of the Commission.⁹ Accordingly, the Commission decided to

request the secretariat to submit to the eighteenth session of the Commission a commentary on the draft text of a model law on international commercial arbitration.⁹

5. The present report has been prepared pursuant to that request. It provides a summary of why a certain provision has been adopted and what it is intended to cover, often accompanied by explanations and interpretations of particular words. It does not give a complete account of the *travaux préparatoires*, including the manifold proposals and draft variants that were not retained. For the benefit of those seeking fuller information on the history of a given provision, the commentary lists the references to the relevant portions of the five session reports of the Working Group.¹⁰

6. In preparing the commentary, the secretariat has taken into account the fact that it is not a commentary on a final text but that its foremost and immediate purpose is to assist the Commission in reviewing and finalizing the text. The secretariat has, therefore, taken the liberty of noting possible ambiguities and inconsistencies, occasionally accompanied by suggestions which the Commission may wish to consider. An attempt has been made to distinguish such views of the secretariat, by using expressions like "it is submitted" or "it is suggested", from those explanations or interpretations which accord with the unanimous or prevailing view of the Working Group.

Analytical commentary¹¹

CHAPTER I. GENERAL PROVISIONS

Article 1. *Scope of application**

(1) This Law applies to international commercial** arbitration, subject to any multilateral or bilateral agreement which has effect in this State.

*Article headings are for reference purposes only and are not to be used for purposes of interpretation.

**The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business co-operation; carriage of goods or passengers by air, sea, rail or road.

¹*Ibid.*, para. 101.

²In order to avoid confusion, no special reference is made to previous article numbers, which, in the course of the preparation, were altered twice. However, any earlier number will be apparent from the relevant discussion in the session report or may be seen from the comparative tables of article numbers set forth in documents A/CN.9/WG.II/WP.40 and A/CN.9/WG.II/L.48, which were submitted to the Working Group at its fifth and seventh sessions.

³The draft text of a model law reproduced here and commented upon is the one which the Working Group on International Contract Practices adopted at the close of its seventh session (A/CN.9/246, para. 14 and annex).

¹Report of the United Nations Commission on International Trade Law on the work of its fourteenth session, *Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17* (A/36/17), para. 70.

²*Ibid.*, para. 65.

³A/CN.9/216.

⁴A/CN.9/232.

⁵A/CN.9/233 and A/CN.9/245.

⁶A/CN.9/246.

⁷Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 101.

⁸*Ibid.*, para. 100.

(2) An arbitration is international if:

(a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States; or

(b) one of the following places is situated outside the State in which the parties have their places of business:

(i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;

(ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or

(c) the subject-matter of the arbitration agreement is otherwise related to more than one State.

(3) For the purposes of paragraph (2) of this article, if a party has more than one place of business, the relevant place of business is that which has the closest relationship to the arbitration agreement. If a party does not have a place of business, reference is to be made to his habitual residence.

References

A/CN.9/216, paras. 16-21

A/CN.9/232, paras. 26-36

A/CN.9/233, paras. 47-60

A/CN.9/245, paras. 160-168, 173

A/CN.9/246, paras. 156-164

Commentary

1. Article 1 of the draft text of a model law on international commercial arbitration (hereinafter referred to as "the Model Law") deals with the intended scope of application of the Model Law. In particular, it lays down the substantive field of application, which is, in accordance with the Commission's mandate to the Working Group,¹² "international commercial arbitration". Before considering this substantive scope of application, some general comments on the form of the Model Law and on further aspects of its application are made.

"This Law applies . . ."

The Model Law as "this Law" of a given State

2. The mode of unification and improvement of national arbitration laws envisaged by the Working Group, subject to final decision by the Commission, is that of a model law. The text, in its final form, would be recommended by the Commission and then by the General Assembly to all States for incorporation into their national legislation.

¹²Report of the United Nations Commission on International Trade Law on the work of its twelfth session, *Official Records of the General Assembly, Thirty-fourth Session, Supplement No. 17 (A/34/17)*, para. 81.

3. To facilitate such incorporation, the text has been drafted in a form in which it could be enacted in a given State. The commentary follows this direction towards a particular State and refers to "this State",¹³ where "this Law" would apply, as State X.

Territorial scope of application (not yet decided)

4. "This Law", in its present form, does not generally state to which individual arbitrations (of international commercial nature) it applies. One possibility would be to use as a determining factor the place of arbitration, that is, to cover all arbitrations taking place in "this State" (X). Another possibility would be to recognize the parties' freedom to select a law other than that of the place of arbitration and to cover all arbitrations taking place in State X, unless the parties have chosen the law of another State, as well as those "foreign" arbitrations for which the parties have selected the law of "this State" (X).

5. The prevailing view in the Working Group was in favour of the first solution (i.e. strict territorial criterion), but the decision was not to deal expressly in article 1 with this issue.¹⁴ The question was also left undecided in the context of article 34, as indicated by the two variants placed between square brackets: "award made [in the territory of this State] [under this Law]".¹⁵ Similarly non-committal is the present wording of article 27 ("arbitral proceedings held in this State or under this Law"), which would accommodate both of the above possibilities.¹⁶

6. The question of the territorial scope of application, which remains to be solved by the Commission, needs to be answered in respect of most but not all provisions of the Model Law. The reason is that certain provisions, dealing with the role of the courts of State X in respect of recognition of arbitration agreements (articles 8 and 9)¹⁷ and recognition and enforcement of awards (articles 35 and 36), are intended to cover arbitration agreements or awards without regard to the place of arbitration or any choice of procedural law.

The Model Law as "lex specialis"

7. Once the Model Law is enacted in State X, "this Law applies" as *lex specialis*, i.e. to the exclusion of all other pertinent provisions of non-treaty law,¹⁸ whether contained, for example, in a code of civil procedure or

¹³A State, when adopting the Model Law, may wish not to retain the expression "this State" (found in articles 1(1), 27(1), 34(1), (2), 35(2), (3) and 36(1)) but, following its normal legislative technique, either substitute appropriate wording (e.g. name of the State) or regard the reference as unnecessary on the ground that it would be clear from the context of the Law and its promulgation.

¹⁴A/CN.9/246, paras. 165-168.

¹⁵*Ibid.*, paras. 169-171. See also commentary to article 34, para. 4.

¹⁶*Ibid.*, paras. 92-97. See also commentary to article 27, para. 3.

¹⁷As regards article 9, a distinction must be made between the right of a party to request an interim measure of protection and the power of the court to grant such measure; see commentary to article 9, paras. 2-3.

¹⁸As to "treaty law", which prevails over the Model Law, see below, paras. 9-11.

in a separate law on arbitration. This priority, while not expressly stated in the Model Law, follows from the legislative intent to establish a special régime for international commercial arbitration.

8. It should be noted (and possibly should be expressed in article 1) that the Model Law prevails over other provisions only in respect of those subject-matters and questions covered by the Model Law. Therefore, other provisions of national law remain applicable if they deal with issues which, though relevant to international commercial arbitration, have been left outside the Model Law (e.g. capacity of parties to conclude arbitration agreement, impact of State immunity, consolidation of arbitral proceedings, competence of arbitral tribunal to adapt contracts, contractual relations between arbitrators and parties or arbitration bodies, fixing of fees and requests for deposits, security for fees or costs, period of time for enforcement of arbitral award).

Model law yields to treaty law

9. According to paragraph (1) of article 1, "this Law" applies "subject to any multilateral or bilateral agreement which has effect in this State". This proviso might be regarded as superfluous since the priority of treaty law would follow in most, if not all, legal systems from the internal hierarchy of sources of law. Nevertheless, it has been retained as a useful declaration of the legislative intent not to affect the validity and operation of multilateral and bilateral agreements in force in State X.

10. The proviso would be of primary relevance with regard to treaties devoted to the same subject-matter as that dealt with in the Model Law. Prominent examples of such multilateral treaties are the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958; hereinafter referred to as the 1958 New York Convention), the European Convention on International Commercial Arbitration (Geneva, 1961; hereinafter referred to as the 1961 Geneva Convention), the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington, 1965; hereinafter referred to as the 1965 Washington Convention) and the Inter-American Convention on International Commercial Arbitration (Panama, 1975).¹⁹

11. It should be noted, however, that the scope of the proviso is wider in that it also covers treaties which are devoted to other subject-matters but contain provisions on arbitration. An example would be the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg), which, by its article 22 (3), reduces the effect of an original agreement on the place of arbitration by providing some alternative places at the

option of the claimant.²⁰ This provision, if in force in State X and applicable to the case at hand, would prevail over article 20 of the Model Law, which recognizes the freedom of the parties to agree on the place of arbitration and gives full effect to such choice, whether made before or after the dispute has arisen.

Substantive scope of application: "international commercial arbitration"

12. The substantive scope of application of the model law, as expressed in its title, is "international commercial arbitration". This widely used term consists of three elements which are, in the Model Law defined, illustrated or accompanied by a declaratory remark.

"Arbitration"

13. The Model Law, like most conventions and national laws on arbitration, does not define the term "arbitration". It merely clarifies, in its article 7 (1), that it covers any arbitration "whether or not administered by a permanent arbitral institution". Thus, it applies to pure *ad hoc* arbitration and to any type of administered or institutional arbitration.

14. Of course, the term "arbitration" is not to be construed as referring only to on-going arbitrations, i.e. arbitral proceedings. It relates also to the time before and after such proceedings, as is clear, for example, from the provisions on recognition of arbitration agreements and, later, of arbitral awards.

15. While the Model Law is generally intended to cover all kinds of arbitration, two qualifications should be mentioned here which are not immediately apparent from the text but may be expressed by any State adopting the Model Law.²¹ The Model Law is designed for consensual arbitration, i.e. arbitration based on voluntary agreement of the parties (as regulated in article 7 (1)); thus, it does not cover compulsory

¹⁹Official Records of the United Nations Conference on the Carriage of Goods by Sea (United Nations publication, Sales No. E.80.VIII.1), part I, Final Act of the United Nations Conference on the Carriage of Goods by Sea (A/CONF.89/13), annex I.

Article 22 (3), (5), (6) of the Hamburg Rules reads as follows:

"3. The arbitration proceedings shall, at the option of the claimant, be instituted at one of the following places:

"(a) a place in a State within whose territory is situated:

"(i) the principal place of business of the defendant or, in the absence thereof, the habitual residence of the defendant; or

"(ii) the place where the contract was made, provided that the defendant has there a place of business, branch or agency through which the contract was made; or

"(iii) the port of loading or port of discharge; or

"(b) any place designated for that purpose in the arbitration clause or agreement.

"4. . . .

"5. The provisions of paragraphs 3 and 4 of this article are deemed to be part of every arbitration clause or agreement, and any term of such clause or agreement which is inconsistent therewith is null and void.

"6. Nothing in this article affects the validity of an agreement relating to arbitration made by the parties after the claim under the contract of carriage by sea has arisen."

²¹A/CN.9/216, para. 17.

¹⁹Another important such treaty is the Convention on the Decision by way of Arbitration of Civil Litigations Resulting from Relations of Economic and Scientific-Technological Co-operation (Moscow, 1972), which, however, deals primarily with compulsory arbitration, while the Model Law is designed for consensual arbitration only (see below, para. 15).

arbitration. Also not covered are the various types of so-called "free arbitration" such as the Dutch *bindend advies*, the German *Schiedsgutachten* or the Italian *arbitrato irrituale*.

"Commercial"

16. The term "commercial" has been left undefined in the Model Law, as in conventions on international commercial arbitration. Although a clear-cut definition would be desirable, no such definition, which would draw a precise line between commercial and non-commercial relationships, could be found. Yet, it was deemed undesirable to leave the matter to the individual States or to provide some guidance for uniform interpretation merely in the session reports of the Working Group or any commentary on the model law. As an intermediate solution, a footnote is annexed to article 1 as an aid in the interpretation of the term "commercial".

17. As regards the form, there may be some uncertainty as to the addressee and the legal effect of this footnote, since such legislative technique is not used in all systems. At the least, the footnote could provide some guidance to the legislator of a State even where it would not be reproduced in the national enactment of the model law. A more far-reaching use, which the Commission may wish to recommend, would be to retain the footnote in the national enactment and, thus, to provide some guidance in the application and interpretation of "this Law".

18. The content of the footnote reflects the legislative intent to construe the term commercial in a wide manner. This call for a wide interpretation is supported by an illustrative list of commercial relationships. Although the examples listed include almost all types of contexts known to have given rise to disputes dealt within international commercial arbitrations, the list is expressly not exhaustive. Therefore, also covered as commercial would be transactions such as supply of electric energy, transport of liquefied gas via pipeline and even "non-transactions" such as claims for damages arising in a commercial context. Not covered are, for example, labour or employment disputes and ordinary consumer claims, despite their relation to business. Of course, the fact that a transaction is covered by the Model Law by virtue of its commercial nature does not necessarily mean that all disputes arising from the transaction are capable of settlement by arbitration (as to the requirement of arbitrability, see commentary to article 7, para. 5).

19. The footnote, while not giving a clear-cut definition, provides guidance for an autonomous interpretation of the term "commercial"; it does not refer, as does the 1958 New York Convention (article I (3)), to what the existing national law regards as commercial. Therefore, it would be wrong to apply national concepts which define as commercial, for example, only those types of relationship dealt with in the commercial code or only those transactions the parties to which are commercial persons.

20. This latter idea of preclusion had been expressed in a previous draft of the footnote by the words (following the first sentence) "irrespective of whether the parties are 'commercial persons' (merchants) under any given national law". This wording, which was exclusively intended to clarify that the commercial nature of the relationship is not dependent on the qualification of the parties as merchants (as used in some national laws for distinguishing between commercial and civil relationships), was nevertheless deleted lest it might be construed as dealing with the issue of State immunity.²²

21. In this connection, it may be noted that the Model Law does not touch upon the sensitive and complex issue of State immunity. For example, it does not say whether the signing of an arbitration agreement by a State organ or governmental agency constitutes a waiver of any such immunity. On the other hand, it seems equally noteworthy that the Model Law covers those relationships to which a State organ or governmental entity is a party, provided, of course, the relationship is of a commercial nature.

"International", paragraph (2)

22. In accordance with the mandate of the Commission, the Model Law is designed to establish a special régime for international cases. It is in these cases that the present disparity between national laws creates difficulties and adversely affects the functioning of the arbitral process. Furthermore, in these cases more flexible and liberal rules are needed in order to overcome local constraints and peculiarities. Finally, in these cases the interest of a State in maintaining its traditional concepts and familiar rules is less strong than in a strictly domestic setting. However, despite this design and legislative self-restraint, any State is free to take the Model Law, whether immediately or at a later stage, as a model for legislation on domestic arbitration and, thus, avoid a dichotomy within its arbitration law.

23. Unless a State opts for such unitary treatment, the test of "internationality" set forth in article 1 (2) is of utmost importance and crucial for the applicability of "this Law". Since it determines whether a given case would be governed by the special régime embodied in the Model Law or by the law on domestic arbitration, the definition should be as precise as possible so as to provide certainty to all those concerned. Unfortunately, the search for an appropriate test reveals a dilemma: A precise formula tends to be too narrow to cover all cases encountered in the practice of international commercial arbitration; and the wider the scope of the test, the more it is likely to lack precision. The solution presented in paragraph (2) starts with a rather precise criterion in subparagraph (a), which covers the great bulk of worthy cases, and then widens its scope in subparagraphs (b) and (c) with an increasing reduction in precision.

²²A/CN.9/246, para. 158

(a) *Parties' places of business in different States, subparagraph (a)*

24. The basic criterion, laid down in subparagraph (a), is modelled on the test of internationality adopted in article 1 (1) of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980;²³ hereinafter referred to as the 1980 Vienna Sales Convention). It uses as determining factor the location of the places of business of the parties to the arbitration agreement. Accordingly, other characteristics of a party such as its nationality or place of incorporation or registration are not determinative.

25. Since a given case is international if the parties have their places of business "in different States", it is irrelevant whether any of these States is State X (i.e. the one enacting "this Law"). Included, thus, is any arbitration between "foreigners" (e.g. parties with place of business in State Y and State Z) and any arbitration between a party in State X and a party in a foreign State (Y). However, whether and to what extent this Law would apply in any such international case is a different question, to be answered according to other rules on the scope of application (discussed above, paras. 4-6). While articles 8, 9, 35 and 36, dealing with recognition of arbitration agreements and awards by the courts of State X, apply without regard to the place of arbitration or any choice of procedural law, the remaining bulk of provisions, dealing in particular with arbitration procedure, would apply only if the case falls within the territorial scope of application.

(b) *Other relevant places, subparagraph (b)*

26. Either of the places listed in subparagraph (b) establishes an international link if situated in a State other than the one where the parties have their places of business. Again, it is without relevance to the test of internationality whether any of these States is State X. Thus, an arbitration would be international under subparagraph (b) in any of the following situations: Parties' places of business in State X and other relevant place in State Y; parties' places of business in State Y and other relevant place in State X; parties' places of business in State Y and other relevant place in State Z. However, whether in fact "this Law" would apply in full depends, again, on whether the case falls within the territorial scope of application.²⁴

27. The places listed in subparagraph (b) relate either to the arbitration (subparagraph (i)) or to the subject-matter of the relationship or the dispute (subparagraph (ii)). The first relevant place is the place of arbitration,

as the only arbitration-related criterion. Thus, the international link would not be established by any other arbitration-related element such as appointment of foreign arbitrator or choice of foreign procedural law (if permissible).

28. The place of arbitration is relevant if determined in, or pursuant to, the arbitration agreement. Where the place of arbitration is specified in the arbitration agreement, the parties know from the start whether their case is international under subparagraph (i). Where the place of arbitration is determined pursuant to the agreement, there may be a long period of uncertainty about this point. It is submitted that this requirement would not be met by a stipulation authorizing the arbitral tribunal to determine the place of arbitration.

29. Under subparagraph (ii), internationality is established if a substantial part of the obligations of the commercial relationship is to be performed in a State other than the one where the parties have their places of business. This would be the case, for example, where a producer and a trader conclude a sole distributorship agreement concerning a foreign market or where a general contractor employs an independent sub-contractor for certain parts of a foreign construction project. While the arbitration agreement must cover any dispute or certain disputes arising out of this relationship, it is not necessary that the dispute itself relates to the international element.

30. Even where no substantial part of the obligations is to be performed abroad, an arbitration would be international under subparagraph (ii) if the subject-matter of the dispute is most closely connected with a foreign place. Since instances of this kind will be very exceptional, one may accept the disadvantage of this criterion which lies in the fact that the international character cannot be determined before the dispute arises.

(c) *Yet other international link, subparagraph (c)*

31. The final criterion, laid down in subparagraph (c), is that "the subject-matter of the arbitration agreement is otherwise related to more than one State". This "residual" test is designed to catch all worthy cases not covered by subparagraphs (a) or (b); it is apparent that this wide scope is accompanied by a considerable degree of imprecision. It may be added that "the subject-matter of the arbitration agreement" is not to be construed as referring to the arbitration itself but to the substantive matters that may be subject to arbitration.

(d) *Determination of place of business, paragraph (3)*

32. If a party has two or more places of business, one of which is in the same State as is the other party's place of business, it is necessary to determine which of his places is relevant for the purposes of paragraph (2). According to paragraph (3), first sentence, it is the one which has the closest relationship to the arbitration agreement. An instance of such close relationship

²³See Official Records of the United Nations Conference on Contracts for the International Sale of Goods (United Nations publication, Sales No. E.81.IV.3), United Nations Convention on Contracts for the International Sale of Goods (A/CONF.97/18), annex I.

²⁴In particular with regard to subparagraph (i), it is noteworthy that "this Law" would apply in full only if the place of arbitration is in State X, assuming that the strict territorial criterion is adopted. The thrust of subparagraph (i) is thus to cover cases where the parties have their places of business not in State X but in another State (provided that the latter State does not prohibit these "domestic" parties from selecting a foreign place of arbitration).

would be that a contract, including an arbitration clause, is fully negotiated by the branch or office in question, even if it is signed at another place (e.g. the principal place of business).

33. As indicated in this example, the location of the principal place of business (or head office) is irrelevant. If one were to take the principal place of business as the decisive criterion, one would have a somewhat wider application of the Model Law since it would cover also those cases where the "closely connected" place of business, but not the principal place of business, is in the same State as is the other party's place of business. Nevertheless, the criterion of "closest connection" was adopted because it was thought to reflect better the expectations of the parties and, in particular, for the sake of consistency with the 1980 Vienna Sales Convention (article 10 (a)).²⁵

34. The second sentence of paragraph (3) deals with the rare situation that a person involved in a commercial transaction does not have an established "place of business". In such case, his habitual residence would be the decisive place for the purposes of paragraph (2).

* * *

Article 2. *Definitions and rules of interpretation*

For the purposes of this Law:

(a) "arbitral tribunal" means a sole arbitrator or a panel of arbitrators;

(b) "court" means a body or organ of the judicial system of a country;

(c) where a provision of this Law leaves the parties free to determine a certain issue, such freedom includes the right of the parties to authorize a third party, including an institution, to make that determination;

(d) where a provision of this Law refers to the fact that the parties have agreed or that they may agree or in any other way refers to an agreement of the parties, such agreement includes any arbitration rules referred to in that agreement;

(e) unless otherwise agreed by the parties, any written communication is deemed to have been received if it is delivered to the addressee personally or if it is delivered at his place of business, habitual residence or mailing address, or, if none of these can be found after making reasonable inquiry, then at the addressee's last-known place of business, habitual residence or mailing address. The communication shall be deemed to have been received on the day it is so delivered.

²⁵In this Convention, the test serves two purposes which tend to balance overall the effects of widening or narrowing the scope of application. One is, as in the Model Law, to distinguish between strictly domestic cases and those of an international character; the other one, foreign to the Model Law, is to distinguish between those international cases where the parties have their places in Contracting States and those international cases where one party has his place of business in a non-contracting State.

References

A/CN.9/233, paras. 75, 101-102

A/CN.9/245, paras. 28, 169-172

A/CN.9/246, paras. 172-173

Commentary

"Arbitral tribunal" and "court" defined, paragraphs (a) and (b)

1. The definition of the terms "arbitral tribunal" and "court" may be regarded as self-evident and, thus, superfluous. However, they have been retained, in particular, for a terminological reason. Their juxtaposition is intended to draw a clear distinction between the two different types of dispute settlement organs. This is to avoid, for example, the misunderstanding, possible in languages such as French and Spanish, that the word "*tribunal*" is an abbreviated form of the term "*tribunal arbitral*" or that the term "court" would include any arbitration body or administering institution bearing the name "court" (e.g. ICC Court of Arbitration or London Court of International Arbitration).

2. Paragraph (b) simply refers to, without interfering with, the national judicial system, which is not necessarily the system of State X (cf. articles 9, 35 (3), 36 (1) (a) (v), (2)). Taking into account the varied nomenclature, the term "court" is not restricted to those organs actually called "court" in a given country but would include any other "competent authority" (such is the expression used in the 1958 New York Convention). The reference to the judicial system of "a country" (instead of "a State") has been used for the sole purpose of avoiding the misconception, possible in a federation of states, that merely "state courts" are covered but not "federal courts".²⁶

Interpretation of "parties' freedom" and "agreement", paragraphs (c) and (d)

3. Paragraphs (c) and (d) are designed to prevent too literal an interpretation of the references in the Model Law to the parties' freedom to determine an issue or to their agreement. According to the reasonable interpretation laid down in paragraph (c), such freedom covers the liberty of the parties not only to decide the issue themselves but also to authorize a third person or institution to determine the issue on their behalf. Practical examples of such issues would be the number of arbitrators, the place of arbitration and other procedural points.

4. Paragraph (d) recognizes the common practice of parties to refer in their agreement to arbitration rules (of institutions, associations or other bodies), instead of negotiating and drafting a fully original and individual ("one-off") arbitration agreement. A general rule of interpretation seems preferable to including a clari-

²⁶The Commission may wish to examine the appropriateness of the term "country", used also in articles 35 (1), (3) and 36 (1), with a view to achieving consistency throughout the Model Law by using exclusively the expression "State".

fication in each of the many provisions of the Model Law where this matter may be relevant.

5. Paragraphs (c) and (d) are overlapping rules in that the freedom to determine an issue (under (c)) is included in the notion that the parties may agree (under (d)) and in that the authorization of a third party (under (c)) is often envisaged in arbitration rules (under (d)). However, this is not so in all cases: an authorization may be added to the régime established by arbitration rules (e.g. designation of an appointing authority), it may be made to replace a provision in these rules, or it may be made in a "one-off" arbitration agreement.

"Receipt of communication" defined, paragraph (e)

6. Paragraph (e), which is modelled on article 2 (1) of the UNCITRAL Arbitration Rules, lists a variety of instances in which a written communication, by a party or the arbitral tribunal, "is deemed to have been received". Despite this latter wording, the list starts with instances of actual (i.e. non-fictional) receipt and then enters into the realm of legal fiction. The last sentence makes it clear that any such instance is not only conclusive of the fact of receipt but also determines the date of receipt.

* * *

(Article 3 deleted)²⁷

* * *

Article 4. *Waiver of right to object*

A party who knows or ought to have known that any provision of this Law from which the parties may derogate or any requirement under the arbitration agreement has not been complied with and yet proceeds with the arbitration without stating his objection to such non-compliance without delay or, if a time-limit is provided therefor, within such period of time, shall be deemed to have waived his right to object.

References

- A/CN.9/233, para. 66
- A/CN.9/245, paras. 176-178
- A/CN.9/246, paras. 178-182

Commentary

1. Where a procedural requirement, whether laid down in the Model Law or in the arbitration agreement, is not complied with, any party has a right to object with a view to getting the procedural defect cured. Article 4 implies a waiver of this right under certain conditions, based on general principles such as estoppel or *venire contra factum proprium*.

2. The first condition is that the procedural requirement, which has not been complied with, is contained either in a non-mandatory provision of the Model Law or in the arbitration agreement. The restriction of this rule to provisions of law from which the parties may derogate was adopted on the ground that an estoppel rule which also covered fundamental procedural defects would be too rigid. It may be mentioned, however, that the Model Law contains specific rules concerning objections with regard to certain fundamental defects such as lack of a valid arbitration agreement or the arbitral tribunal's exceeding its mandate (article 16 (2)). As regards non-compliance with a requirement under the arbitration agreement, it may be noted that the procedural stipulation by the parties must be valid and, in particular, not be in conflict with a mandatory provision of "this Law".

3. The second condition is that the party knew or ought to have known of the non-compliance. It is submitted that the expression "ought to have known" should not be construed as covering every kind of negligent ignorance but merely those instances where a party could not have been unaware of the defect. This restrictive interpretation, which might be expressed in the article, seems appropriate in view of the principle which justifies statutory implication of a waiver.

4. The third condition is that the party does not state his objection without delay or, if a time-limit is provided therefor, within such period of time. This latter reference to time is, logically speaking, the first one to be examined since a time-limit, whether provided for in the Model Law or the arbitration agreement, has priority over the general formula "without delay".

5. There is yet another condition which should not be overlooked. A party loses his right to object only if, without stating his objection, he proceeds with the arbitration. Acts of such "proceeding" would include, for example, appearance at a hearing or a communication to the arbitral tribunal or the other party. Therefore, a party would not be deemed to have waived his right if, for instance, a postal strike or similar impediment prevented him for an extended period of time from sending any communication at all.

6. Where, by virtue of article 4, a party is deemed to have waived his right to object, he is precluded from raising the objection during the subsequent phases of the arbitral proceedings and, what may be of greater practical relevance, after the award is rendered. In particular, he may not then invoke the non-compliance as a ground for setting aside the award or as a reason for refusing its recognition or enforcement. Of course, a waiver has this latter effect only in cases where article 4 is applicable, i.e. with regard to those awards which are made "under this Law" (whatever criterion may be adopted for the territorial scope of application). It is submitted that a court from which recognition or enforcement of any other award is sought could also disregard late objections of a party by applying any similar rule of the applicable procedural law or the general idea of estoppel.

* * *

²⁷Previous draft article 3 was deleted by the Working Group at its seventh session (A/CN.9/246, paras. 174-177). To avoid confusion, the re-numbering of articles has been postponed until the final stages of the revision of the draft by the Commission.

Article 5. *Scope of court intervention*

In matters governed by this Law, no court shall intervene except where so provided in this Law.

References

- A/CN.9/233, paras. 69-73
A/CN.9/245, paras. 183-184
A/CN.9/246, paras. 183-188

Commentary

1. This article relates to the crucial and complex issue of the role of courts with regard to arbitrations. The Working Group adopted it on a tentative basis and invited the Commission to reconsider that decision in the light of comments by Governments and international organizations.²⁸ In assessing the desirability and appropriateness of this provision, the following considerations should be taken into account.

2. Although the provision, due to its categorical wording,²⁹ may create the impression that court intervention is something negative and to be limited to the utmost, it does not itself take a stand on what is the proper role of courts. It merely requires that any instance of court involvement be listed in the Model Law. Its effect would, thus, be to exclude any general or residual powers given to the courts in a domestic system which are not listed in the Model Law. The resulting certainty of the parties and the arbitrators about the instances in which court supervision or assistance is to be expected seems beneficial to international commercial arbitration.

3. Consequently, the desired balance between the independence of the arbitral process and the intervention by courts should be sought by expressing all instances of court involvement in the Model Law but cannot be obtained within article 5 or by its deletion. The Commission may, thus, wish to consider whether any further such instance need be included, in addition to the various instances already covered in the present text. These are not only the functions entrusted to the Court specified in article 6, i.e. the functions referred to in articles 11 (3), (4), 13 (3), 14 and 34 (2), but also those instances of court involvement envisaged in articles 9 (interim measures of protection), 27 (assistance in taking evidence), 35 and 36 (recognition and enforcement of awards).

4. Another important consideration in judging the impact of article 5 is that the above necessity to list all instances of court involvement in the Model Law applies only to the "matters governed by this Law".

²⁸A/CN.9/246, para. 186

²⁹A less categorical wording was suggested at the seventh session of the Working Group but was not adopted: "In matters governed by this Law concerning the arbitral proceedings or the composition of the arbitral tribunal, courts may exercise supervisory or assisting functions only if so provided in this Law" (A/CN.9/246, paras. 183-184).

The scope of article 5 is, thus, narrower than the substantive scope of application of the Model Law, i.e. "international commercial arbitration" (article 1), in that it is limited to those issues which are in fact regulated, whether expressly or impliedly, in the Model Law.

5. Article 5 would, therefore, not exclude court intervention in any matter not regulated in the Model Law. Examples of such matters include the impact of State immunity, the contractual relations between the parties and the arbitrators or arbitral institution, the fees and other costs, including security therefor, as well as other issues mentioned above in the discussion on the character of the Model Law as "lex specialis" where the same distinction has to be made.³⁰

6. It is submitted that the distinction is reasonable, even necessary, although it is not in all cases easily made. For example, article 18 governs the arbitral tribunal's ordering of interim measures of protection, by implying an otherwise doubtful power, but it does not regulate the possible enforcement of these orders. A State would, thus, not be precluded (by article 5) from either empowering the arbitral tribunal to take itself certain measures of compulsion (as known in some legal systems) or providing for enforcement by courts (as known in other systems).³¹ On the other hand, where the Model Law, for example, grants the parties freedom to agree on a certain point (e.g. appointment of arbitrator, article 11 (2)), the matter is thereby fully regulated, to the exclusion of court intervention (e.g. any court confirmation, as required under some laws even in the case of a party-appointed arbitrator).

* * *

Article 6. *Court for certain functions of arbitration assistance and supervision*

The Court with jurisdiction to perform the functions referred to in articles 11 (3), (4), 13 (3), 14 and 34 (2) shall be the . . . (blanks to be filled by each State when enacting the Model Law).

References

- A/CN.9/232, paras. 89-98
A/CN.9/233, paras. 82-86
A/CN.9/245, paras. 190-191
A/CN.9/246, paras. 189-190

Commentary

1. Article 6 calls upon each State adopting the model law to designate a particular Court which would perform certain functions of arbitration assistance and supervision. The functions referred to in this article relate to the appointment of an arbitrator (article 11 (3), (4)), the challenge of an arbitrator (article 13 (3)), the

³⁰See commentary to article 1, para. 8.

³¹See commentary to article 18, para. 4.

termination of the mandate of an arbitrator because of his failure to act (article 14) and the setting aside of an arbitral award (article 34 (2)).

2. To concentrate these arbitration-related functions in a specific Court is expected to result in the following advantages. It would help parties, in particular foreign ones, more easily to locate the competent court and obtain information on any relevant features of that "Court", including its policies adopted in previous decisions. Even more beneficial to the functioning of international commercial arbitration would be the expected specialization of that Court.

3. Although these two advantages would best be achieved by a full centralization, the designation of a Court does not necessarily mean that it will in fact be only one individual court in each State. In particular, larger countries may wish to designate one type or category of courts, for example, any commercial courts or commercial chambers of district courts.

4. The designated Court need not necessarily be a full court or a chamber thereof. It may well be, for example, the president of a court or the presiding judge of a chamber for those functions which are of a more administrative nature and where speed and finality are particularly desirable (i.e. articles 11, 13 and 14). To what extent this further expected advantage will materialize depends on each State's provisions on court organization or procedure, whether they already exist or are adopted together with "this Law". It is submitted that a State may entrust these administrative functions even to a body outside its court system, for example, a national arbitration commission or institution handling international cases.

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CHAPTER II. ARBITRATION AGREEMENT

Article 7. *Definition and form of arbitration agreement*

(1) "Arbitration agreement" is an agreement by the parties to submit to arbitration, whether or not administered by a permanent arbitral institution, all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

(2) The arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the reference is such as to make that clause part of the contract.

References

- A/CN.9/216, paras. 22-24, 26
- A/CN.9/232, paras. 37-46
- A/CN.9/233, paras. 61-68
- A/CN.9/245, paras. 179-182
- A/CN.9/246, paras. 17-19

Commentary

Definition (and recognition), paragraph (1)

1. Paragraph (1) describes the important legal instrument which forms the basis and justification of an arbitration. The term "arbitration agreement" is defined along the lines of article II (1) of the 1958 New York Convention; as more clearly expressed in that Convention, there is an implied guarantee of recognition which goes beyond a mere definition.

2. The Model Law recognizes not only an agreement concerning an existing dispute (*compromis*) but also an agreement concerning any future dispute (*clause compromissoire*). Inclusion of this latter type of agreement seems imperative in view of its frequent use in international arbitration practice and will, it is hoped, contribute to global unification in view of the fact that at present some national laws do not give full effect to this type.

3. The Model Law recognizes an arbitration agreement irrespective of whether it is in the form of an arbitration clause contained in a contract or in the form of a separate agreement. Thus, any existing national requirement that the agreement be in a separate document would be abolished. By the nature of things, an arbitration clause in a contract would be appropriate for future disputes, while a separate agreement is suitable not only for an existing dispute but also for any future disputes.

4. The Model Law recognizes an arbitration agreement if the existing or future dispute relates to a "defined legal relationship, whether contractual or not". It is submitted that the expression "defined legal relationship" should be given a wide interpretation so as to cover all non-contractual commercial cases occurring in practice (e.g. third party interfering with contractual relations; infringement of trade mark or other unfair competition).

5. The Model Law provisions on the arbitration agreement do not retain the requirement, expressed in article II (1) of the 1958 New York Convention, that the dispute concern "a subject-matter capable of settlement by arbitration". However, this does not mean that the Model Law would give full effect to any arbitration agreement irrespective of whether the subject-matter is arbitrable. The Working Group, when discussing pertinent proposals, recognized the importance of the requirement of arbitrability but saw no need for an express provision.³² It was noted, for example, that an arbitration agreement covering a non-arbitrable subject-

³²A/CN.9/246, para. 23; similarly, A/CN.9/245, para. 187; cf. also A/CN.9/232, para. 40.

matter would normally, or at least in some jurisdictions, be regarded as null and void and that the issue of non-arbitrability was adequately addressed in articles 34 and 36.³³ In this connection, it may be noted that the Working Group decided at an early stage not to deal with the material validity of the arbitration agreement and not to attempt to achieve unification or at least certainty as to which subject-matters are non-arbitrable, either by listing them in the Model Law or calling upon each State to list them exclusively in "this Law".³⁴

Requirement of written form, paragraph (2)

6. The Model Law follows the 1958 New York Convention in requiring written form, although, in commercial arbitration, oral agreements are not unknown in practice and are recognized by some national laws. In a way, the Model Law is even stricter than that Convention in that it disallows reliance on a "more favourable provision" in the subsidiary national law (on domestic arbitration), as would be possible under that Convention by virtue of its article VII (1). The Model Law is intended to govern all international commercial arbitration agreements and, as provided in article 7 (2), requires that they be in writing.³⁵ However, non-compliance with that requirement may be cured by submission to the arbitral proceedings, i.e. participation without raising the plea referred to in article 16 (2).³⁶

7. The definition of written form is modelled on article II (2) of the 1958 New York Convention but with two useful additions. It widens and clarifies the range of means which constitute a writing by adding "telex or other means of telecommunication which provide a record of the agreement", in order to cover modern and future means of communication.

8. The second addition, contained in the last sentence, is intended to clarify a matter which, in the context of the 1958 New York Convention, has led to problems and divergent court decisions. It deals with the not-infrequent case where parties, instead of including an arbitration clause in their contract, refer to a document (e.g. general conditions or another contract) which contains an arbitration clause. The reference constitutes an arbitration agreement if it is such as to make that clause part of the contract and, of course, if the contract itself meets the requirement of written form as defined in the first sentence of paragraph (2). As the text clearly states, the reference need only be to the document; thus, no explicit reference to the arbitration clause contained therein is required.³⁷

* * *

³³As regards article 34, where the inclusion of the non-arbitrability of the subject-matter is controversial, see commentary to article 34, para. 12.

³⁴A/CN.9/216, paras. 25, 30-31.

³⁵A/CN.9/233, para. 66; A/CN.9/232, para. 46.

³⁶As to the possible need for modifying article 35 (2) in order to accommodate the situation of a cured defect of form, see footnote 91.

³⁷Cf. A/CN.9/246, para. 19.

Article 8. Arbitration agreement and substantive claim before court

(1) A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

(2) Where, in such case, arbitral proceedings have already commenced, the arbitral tribunal may continue the proceedings while the issue of its jurisdiction is pending with the court.

References

A/CN.9/216, paras. 35-36

A/CN.9/232, paras. 49-51, 146, 151

A/CN.9/233, paras. 74-81

A/CN.9/245, paras. 66-69, 185-187

A/CN.9/246, paras. 20-23

Commentary

1. Article 8 deals with an important "negative" effect of an arbitration agreement. The agreement to submit a certain matter to arbitration means that this matter shall not be heard and decided upon by any court, irrespective of whether this exclusion is expressed in the agreement. If, nevertheless, a party starts litigation, the court shall refer the parties to arbitration unless it finds the agreement to be null and void, inoperative or incapable of being performed.

2. Article 8 is closely modelled on article II (3) of the 1958 New York Convention, with two useful elements added. Due to the nature of the Model Law, article 8 (1) of "this Law" is addressed to all courts of State X; it is not limited to agreements providing for arbitration in State X and, thus, wide acceptance of the Model Law would contribute to the universal recognition and effect of international commercial arbitration agreements.

3. As under the 1958 New York Convention, the court would refer the parties to arbitration, i.e. decline (the exercise of its) jurisdiction, only upon request by a party and, thus, not on its own motion. A time element has been added that the request be made at the latest with or in the first statement on the substance of the dispute. It is submitted that this point of time should be taken literally and applied uniformly in all legal systems, including those which normally regard such a request as a procedural plea to be raised at an earlier stage than any pleadings on substance.

4. As regards the effect of a party's failure to invoke the arbitration agreement by way of such a timely request, it seems clear that article 8 (1) prevents that party from invoking the agreement during the subsequent phases of the court proceedings. It may be noted that the Working Group, despite the wide

support for the view that the failure of the party should preclude reliance on the agreement also in other proceedings or contexts, decided not to incorporate a provision on such general effect because it would be impossible to devise a simple rule which would satisfactorily deal with all the aspects of this complex issue.³⁴

5. Another addition to the original text in the 1958 New York Convention is the rule in paragraph (2) which confirms that paragraph (1) applies irrespective of whether arbitral proceedings have already commenced. It empowers an arbitral tribunal to continue the arbitral proceedings (if governed by "this Law") while the issue of its jurisdiction is pending with a court. The purpose of giving such discretion to the arbitral tribunal is to reduce the risk and effect of dilatory tactics of a party reneging on his commitment to arbitration.

* * *

Article 9. *Arbitration agreement and interim measures by court*

It is not incompatible with the arbitration agreement for a party to request, before or during arbitral proceedings, from a court an interim measure of protection and for a court to grant such measure.

References

- A/CN.9/216, para. 39
- A/CN.9/232, paras. 52-56
- A/CN.9/233, paras. 74, 81
- A/CN.9/245, paras. 185, 188-189
- A/CN.9/246, paras. 24-26

Commentary

1. Article 9 relates—like article 8—to recognition and effect of the arbitration agreement but in another respect. It lays down the principle, disputed in some jurisdictions, that resort to a court and subsequent court action with regard to interim measures of protection are compatible with an arbitration agreement. It thus makes it clear that the "negative" effect of an arbitration agreement, which is to exclude court jurisdiction, does not operate with regard to such interim measures. The main reason is that the availability of such measures is not contrary to the intentions of parties agreeing to submit a dispute to arbitration and that the measures themselves are conducive to making the arbitration efficient and to securing its expected results.

2. Article 9 expresses the principle of compatibility in two directions with different scope of application. According to the first part of the provision, a request by a party for any such court measures is not incompatible with the arbitration agreement, i.e. neither prohibited nor

to be regarded as a waiver of the agreement. This part of the rule applies irrespective of whether the request is made to a court of State X or of any other country. Wherever it may be made, it may not be invoked or treated as an objection against, or disregard of, a valid arbitration agreement under "this Law", i.e. in arbitration cases falling within its territorial scope of application or in the context of articles 8 and 36.

3. However, the second part of the provision is addressed only to the courts of State X and declares their measures to be compatible with an arbitration agreement irrespective of the place of arbitration. Assuming wide adherence to the Model Law, these two parts of the provision would supplement each other and go a long way towards global recognition of the principle of compatibility, which, in the context of the 1958 New York Convention, has not been uniformly accepted.

4. The range of interim measures of protection covered by article 9 is considerably wider than that under article 18, due to the different purposes of these two articles. Article 18 deals with the limited power of the arbitral tribunal to order any party to take an interim measure of protection in respect of the subject-matter of the dispute and does not deal with enforcement of such orders. Article 9 deals with the compatibility of the great variety of possible measures by courts available in different legal systems, including not only steps by the parties to conserve the subject-matter or to secure evidence but also other measures, possibly required from a third party, and their enforcement. This would, in particular, include pre-award attachments and any similar seizure of assets.

5. It may be noted that the Model Law does not deal with the possible conflict between an order by the arbitral tribunal under article 18 and a court decision under article 9 relating to the same object or measure of protection. However, it is submitted that the potential for such conflict is rather small in view of the above disparity in the range of measures covered by the two articles.

* * *

CHAPTER III. COMPOSITION OF ARBITRAL TRIBUNAL

Article 10. *Number of arbitrators*

- (1) The parties are free to determine the number of arbitrators.
- (2) Failing such determination, the number of arbitrators shall be three.

References

- A/CN.9/216, paras. 46-48
- A/CN.9/232, paras. 78-82
- A/CN.9/233, paras. 92-93
- A/CN.9/245, paras. 194-195
- A/CN.9/246, paras. 27-28

³⁴A/CN.9/246, para. 22.

Commentary

1. Article 10 is the first article presenting and illustrating the "two-level system" so typical of the Model Law. The first provision falls in the category of articles which recognize the parties' freedom and give effect to their agreement, to the exclusion of any existing national law provision on the issue.³⁹ The second provision falls in the category of suppletive rules which provide those parties failing to regulate the procedure by agreement with a set of rules for getting the arbitration started and proceeding to a final settlement of the dispute.⁴⁰

2. Paragraph (1) recognizes the parties' freedom to determine the number of arbitrators. Thus, the choice of any number would be given effect, even in those legal systems which at present require an uneven number. As generally stated in article 2(c), the freedom of the parties is not limited to determining the issue themselves but includes the right to authorize a third party to make that determination.

3. For those cases where the number of arbitrators has not been determined in advance or cannot be determined in time, paragraph (2) prevents a possible delay or deadlock by supplying the number. The number three was adopted, as in the UNCITRAL Arbitration Rules (article 5), in view of the fact that it appears to be the most common number in international commercial arbitration. However, arbitrations conducted by a sole arbitrator are also common, in particular in less complex cases. It is thought that those parties who want only one arbitrator for the sake of saving time and costs would normally agree thereon, with an inducement to do so added by this paragraph.

* * *

Article 11. *Appointment of arbitrators*

(1) No person shall be precluded by reason of his nationality from acting as an arbitrator, unless otherwise agreed by the parties.

(2) The parties are free to agree on a procedure of appointing the arbitrator or arbitrators, subject to the provisions of paragraphs (4) and (5) of this article.

(3) Failing such agreement,

(a) in an arbitration with three arbitrators, each party shall appoint one arbitrator, and the two arbitrators thus appointed shall appoint the third arbitrator; if a party fails to appoint the arbitrator within thirty days after having been requested to do so by the other party, or if the two arbitrators fail to agree on the third arbitrator within thirty days of their appointment, the appointment shall be made, upon request of a party, by the Court specified in article 6;

(b) in an arbitration with a sole arbitrator, if the parties are unable to agree on the arbitrator, he shall

be appointed, upon request of a party, by the Court specified in article 6.

(4) Where, under an appointment procedure agreed upon by the parties,

(a) a party fails to act as required under such procedure; or

(b) the parties, or two arbitrators, are unable to reach an agreement expected of them under such procedure; or

(c) an appointing authority fails to perform any function entrusted to it under such procedure,

any party may request the Court specified in article 6 to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.

(5) A decision on a matter entrusted by paragraph (3) or (4) of this article to the Court specified in article 6 shall be final. The Court, in appointing an arbitrator, shall have due regard to any qualifications required of the arbitrator by the agreement of the parties and to such considerations as are likely to secure the appointment of an independent and impartial arbitrator and, in the case of a sole or third arbitrator, shall take into account as well the advisability of appointing an arbitrator of a nationality other than those of the parties.

References

A/CN.9/216, paras. 41, 49-50

A/CN.9/232, paras. 73-74, 83-88

A/CN.9/233, paras. 87-88, 94-100

A/CN.9/245, paras. 192-193, 196-201

A/CN.9/246, paras. 29-32

Commentary

No legislative discrimination of foreign nationals, paragraph (1)

1. Some national laws preclude foreigners from acting as arbitrators even in international cases. Paragraph (1) is designed to overcome such national bias on the part of the legislator.⁴¹ As indicated by the words "unless otherwise agreed by the parties", it is not intended to preclude parties (or trade associations or arbitral institutions) from specifying that nationals of certain States may, or may not, be appointed as arbitrators.

Freedom to agree on appointment procedure, paragraph (2)

2. Paragraph (2) recognizes the freedom of the parties to agree on a procedure of appointing the arbitrator or

³⁹Cf. A/CN.9/207, para. 13.

⁴⁰Cf. A/CN.9/207, paras. 17-18.

⁴¹At the sixth session of the Working Group, a concern was expressed that it would be difficult to implement this provision in States where nationals of certain other States were precluded from serving as arbitrators; it was noted in response that the Model Law, not being a convention, would not exclude the possibility for a State to reflect its particular policies in national legislation (A/CN.9/245, para. 193).

arbitrators. This freedom to agree is to be given a wide interpretation in accordance with the general provisions of article 2 (c) and (d).

3. The scope of the parties' freedom is, however, somewhat limited by the mandatory provisions in paragraphs (4) and (5). Parties may not exclude, in their agreement on the appointment, the right of a party under paragraph (4) to resort to the Court specified in article 6 in any of the situations described in that paragraph, or exclude the finality of the Court's decision provided for in paragraph (5).⁴²

Court assistance in agreed appointment procedure, paragraph (4)

4. Paragraph (4) describes three possible defects in typical appointment procedures and provides a cure thereof by allowing any party to request the Court specified in article 6 to take the necessary measure instead (i.e. instead of the "failing" party, persons or authority referred to in subparagraphs (a), (b) or (c)). Assistance by this Court is provided in order to avoid any deadlock or undue delay in the appointment process. Such assistance is not needed if the parties themselves have, in their agreement on the appointment procedure, provided other means for securing the appointment. It may be noted, however, that the mere designation of an appointing authority is not fully sufficient in this regard since it would not meet the contingency described in subparagraph (c).

Suppletive rules on appointment procedure, paragraph (3)

5. Paragraph (3) supplies those parties that have not agreed on a procedure for the appointment with a system for appointing either three arbitrators or one arbitrator, these numbers being the two most common ones in international cases. Subparagraph (a) lays down the rules for the appointment of three arbitrators, whether this number has been agreed upon by the parties under article 10 (1) or whether it follows from article 10 (2). Subparagraph (b) lays down the method of appointing a sole arbitrator for those cases where the parties have made no provision for the appointment, except to agree on the number (i.e. one).

6. In both cases a last resort to the Court specified in article 6 is envisaged in order to avoid any deadlock in the appointment process. There is a difference, however, as regards the time element. While subparagraph (a) sets twice a time-limit (of thirty days) for the sake of certainty, subparagraph (b) does not fix a time-limit but merely refers to the parties' inability to agree. This general wording seems acceptable in this latter case since the persons expected to agree are the parties and their inability to do so becomes apparent from the request to the Court by one of them.

Rules and guidelines for decision of Court, paragraph (5)

7. According to paragraph (5), the decision of the Court shall be final, whether it relates to a matter

entrusted to it by the suppletive rules of paragraph (3) or by the mandatory provision of paragraph (4) in cases where an agreed appointment procedure fails to secure the appointment. Finality seems appropriate in view of the administrative nature of the function and essential in view of the need to constitute the arbitral tribunal as soon as possible.

8. In any case of appointment, the Court shall have due regard to any qualifications required by the agreement of the parties and to such considerations as are likely to secure the appointment of an independent and impartial arbitrator. It is submitted that these criteria are binding since they follow from the arbitration agreement or, as regards impartiality and independence, from article 12, while the special guideline for the appointment of a sole or third arbitrator could be invalidated by a contrary stipulation of the parties.

* * *

Article 12. *Grounds for challenge*

(1) When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose any circumstances likely to give rise to justifiable doubts as to his impartiality or independence. An arbitrator, from the time of his appointment and throughout the arbitral proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him.

(2) An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his impartiality or independence. A party may challenge an arbitrator appointed by him, or in whose appointment he has participated, only for reasons of which he becomes aware after the appointment has been made.

References

- A/CN.9/216, paras. 42-43
- A/CN.9/232, paras. 57-60
- A/CN.9/233, paras. 103-106
- A/CN.9/245, paras. 202-204
- A/CN.9/246, paras. 33-34

Commentary

1. Article 12 implements in two ways the principle that arbitrators shall be impartial and independent. Paragraph (1) requires any prospective or appointed arbitrator to disclose promptly any circumstances likely to cast doubt on his impartiality or independence. Paragraph (2) lays the basis for securing impartiality and independence by recognizing those circumstances which give rise to justifiable doubts in this respect as reasons for a challenge.

2. The duty of a prospective arbitrator to disclose any circumstances of the type referred to in paragraph (1) is designed to inform and alert the person approaching

⁴²It is submitted that the last part of paragraph (5) relating to the appointment of a sole or third arbitrator should not be mandatory (see below, para. 8).

him at an early stage about possible doubts and, thus, helps to prevent the appointment of an unacceptable candidate. Disclosure is required not only where a party or the parties approach the candidate but also where he is contacted by an arbitral institution or other appointing authority involved in the appointment procedure.

3. As stated in the second sentence of paragraph (1), even an appointed arbitrator is, and continues to be, under that duty, essentially for two purposes. The first is to provide the information to any party who did not obtain it before the arbitrator's appointment. The second is to secure information about any circumstances which only arise at a later stage of the arbitral proceedings (e.g. new business affiliation or share acquisitions).

4. Paragraph (2), like article 10 (1) of the UNCITRAL Arbitration Rules, adopts a general formula for the grounds on which an arbitrator may be challenged. This seems preferable to listing all possible connections and other relevant situations. As indicated by the word "only", the grounds for challenge referred to here are exhaustive. Although reliance on any specific reason listed in a national law (often applicable to judges and arbitrators alike) is precluded, it is submitted that it would be difficult to find any such reason which would not be covered by the general formula.

5. It may be noted that the Working Group was of the view that the issue of the arbitrator's competence or other qualifications, specified by the parties, was more closely related to the conduct of the proceedings than to the initial appointment.⁴³ It would, thus, have to be considered under article 14 and possibly article 19 (3).⁴⁴ However, it is submitted in this connection that the conduct of an arbitrator may be relevant under article 12 (2), for example, where any of his actions or statements gives rise to justifiable doubts as to his impartiality or independence. The Commission may wish to consider expressing this interpretation in the text since the word "circumstances" and the close connection with paragraph (1) could lead to a narrower interpretation which would not cover such instances of biased behaviour or misconduct.

6. The second sentence of paragraph (2) estops a party from challenging an arbitrator, whom he himself appointed or in whose appointment he participated, on any ground which he already knew before the appointment. In such case, that party should not have appointed, or agreed to the appointment of, the candidate whose impartiality or independence was in doubt. It is submitted that "participation in the appointment" covers not only the case where the parties jointly appoint an arbitrator (e.g. under article 11 (3) (b)) but also a less direct involvement such as the one under the list procedure envisaged in the UNCITRAL Arbitration Rules (article 6 (3)).

* * *

Article 13. *Challenge procedure*

(1) The parties are free to agree on a procedure for challenging an arbitrator, subject to the provisions of paragraph (3) of this article.

(2) Failing such agreement, a party who intends to challenge an arbitrator shall, within fifteen days of the constitution of the arbitral tribunal or after becoming aware of any circumstance referred to in article 12 (2), whichever is the later, send a written statement of the reasons for the challenge to the arbitral tribunal. Unless the challenged arbitrator withdraws from his office or the other party agrees to the challenge, the arbitral tribunal shall decide on the challenge.

(3) If a challenge under any procedure agreed upon by the parties or under the procedure of paragraph (2) of this article is not successful, the challenging party may request, within fifteen days after having received notice of the decision rejecting the challenge, the Court specified in article 6 to decide on the challenge, which decision shall be final; while such a request is pending, the arbitral tribunal, including the challenged arbitrator, may continue the arbitral proceedings.

References

- A/CN.9/216, paras. 44-45
- A/CN.9/232, paras. 61-65
- A/CN.9/233, paras. 107-111
- A/CN.9/245, paras. 205-212
- A/CN.9/246, paras. 36-39

Commentary

Freedom to agree, and its limits, paragraph (1)

1. Paragraph (1) recognizes the freedom of the parties to agree on a procedure for challenging an arbitrator, while the reasons for such a challenge are exhaustively laid down in the mandatory provision of article 12 (2).

2. The Model Law thus gives full effect to any agreement on how a challenge may be brought and decided upon. However, there is one specific restriction.⁴⁵ The parties may not exclude the last resort to the Court provided for in paragraph (3). This restriction, unlike the one in article 11 (2) and (4),⁴⁶ applies irrespective of whether the parties have authorized any other body, e.g. an appointing authority, to take the final decision on the challenge. It is submitted that in such a case the challenging party would have to exhaust the available remedies and seek a decision by that body; but that decision would not be final since the last resort to the Court specified in article 6 cannot be excluded by agreement of the parties.

⁴³A/CN.9/233, para. 105.

⁴⁴See commentary to article 14, para. 4, and to article 19, para. 9.

⁴⁵There is also a general restriction since, it is submitted, the fundamental principles laid down in article 19 (3) extend to such procedural agreement. See commentary to article 19, para. 7.

⁴⁶Cf. commentary to article 11, paras. 3-4.

Suppletive rules on challenge procedure, paragraph (2)

3. Paragraph (2) supplies those parties who have not agreed on a challenge procedure with a system of challenge by specifying the period of time and the form for bringing a challenge and the mode of deciding thereon, subject to ultimate judicial control as provided in paragraph (3).

4. As stated in the second sentence of paragraph (2), the challenge would be decided upon by the arbitral tribunal if a decision is needed, i.e. where the challenged arbitrator does not withdraw from his office or the other party disagrees with the challenge. To let the arbitral tribunal decide on the challenge is obviously without practical relevance in the case of a sole arbitrator who has been challenged and does not resign. However, where one of three arbitrators is challenged it has some merits, despite the possible psychological difficulties of making the arbitral tribunal decide on a challenge of one of its members. At least where the challenge is not frivolous or obviously unfounded, an advantage could be to save time and expense by making the last resort to the Court unnecessary. It may be added that such a decision is not one on a question of procedure within the meaning of article 29 (second sentence) and would, thus, have to be made by all or a majority of the members (article 29, first sentence).⁴⁷ This means that a challenge will be sustained only if the two other members decide in favour of the challenging party.

Ultimate judicial control, paragraph (3)

5. Paragraph (3) grants any challenging party who was unsuccessful in the procedure agreed upon by the parties or in the one under paragraph (2) a last resort to the Court specified in article 6. The provision, in its most crucial part, adopts a compromise solution with regard to the controversy of whether any resort to a court should be allowed only after the final award is made or whether a decision during the arbitral proceedings is preferable. The main reason in support of the first position is that it prevents dilatory tactics; the main reason in support of the second position is that a prompt decision would soon put an end to the undesirable situation of having a challenged arbitrator participate in the proceedings and would, in particular, avoid waste of time and expense in those cases where the court later sustains the challenge.

6. Paragraph (3), like article 14 but unlike article 16 (3), provides for court intervention during the arbitral proceedings; however, it includes three features designed to minimize the risk and adverse effects of dilatory tactics. The first element is the short period of time of fifteen days for requesting the Court to overrule the negative decision of the arbitral tribunal or any other body agreed upon by the parties. The second feature is that the decision by the Court shall be final; in addition to excluding appeal, other measures relating to the organization of the Court specified in article 6 may accelerate matters.⁴⁸ The third feature is that the arbitral tribunal, including the challenged arbitrator, may continue the arbitral proceedings while the request

is pending with the Court; it would certainly do so if it regards the challenge as totally unfounded and serving merely dilatory purposes.

* * *

Article 14. Failure or impossibility to act

If an arbitrator becomes *de jure* or *de facto* unable to perform his functions or for other reasons fails to act, his mandate terminates if he withdraws from his office or if the parties agree on the termination. Otherwise, if a controversy remains concerning any of these grounds, any party may request the Court specified in article 6 to decide on the termination of the mandate, which decision shall be final.

References

- A/CN.9/216, para. 50
- A/CN.9/232, paras. 66-69
- A/CN.9/233, paras. 112-117
- A/CN.9/245, paras. 213-216
- A/CN.9/246, paras. 40-42

Commentary

1. Article 14 deals with the termination of the mandate of an arbitrator who becomes *de jure* or *de facto* unable to perform his functions or for other reasons fails to act. In any such case his mandate terminates if he withdraws from his office or if the parties agree on the termination or where this consequence is so self-evident that neither withdrawal nor agreement is needed as, for example, in the case of death.

2. Otherwise, the Court specified in article 6 shall, upon request of a party, make a final decision on the termination of the mandate if there remains a controversy concerning any of the above grounds. A need for such court assistance will rarely arise with regard to *de jure* or *de facto* impossibility and will most probably relate to the less precise ground of "failure to act".

3. This formula, taken from the UNCITRAL Arbitration Rules (article 13 (2)), is admittedly vague, in particular as regards the (undefined) time element inherent in the term "failure". It is, nevertheless, used here since no other acceptable, more detailed formula could be found which would be sufficiently flexible to cover the great variety of situations in which retention of a "non-performing" arbitrator becomes intolerable.

4. It is submitted that in judging whether an arbitrator failed to act, the following considerations may be relevant: Which action was expected or required of him in the light of the arbitration agreement and the specific procedural situation? If he has not done anything in this regard, has the delay been so inordinate as to be unacceptable in the light of the circumstances, including technical difficulties and the complexity of the case? If he has done something and acted in a certain way, did his conduct fall clearly below the standard of what may reasonably be expected from an arbitrator? Amongst

⁴⁷Cf. A/CN.9/246, para. 38.

⁴⁸See commentary to article 6, para. 4.

the factors influencing the level of expectations are the ability to function efficiently and expeditiously and any special competence or other qualifications required of the arbitrator by agreement of the parties.

5. It may be noted that article 14 does not cover all grounds which lead to a termination of the mandate of an arbitrator. Other grounds are to be found in article 15.⁴⁹

* * *

Article 14 *bis*

The fact that, in cases under article 13 (2) or 14, an arbitrator withdraws from his office or a party agrees to the termination of the mandate of an arbitrator does not imply acceptance of the validity of any ground referred to in article 12 (2) or 14.

References

- A/CN.9/233, paras. 107, 109
A/CN.9/245, paras. 208, 213, 215
A/CN.9/246, paras. 33, 35

Commentary

1. Article 14 *bis* provides that the withdrawal of an arbitrator or the consent of a party to the termination of his mandate, whether under article 13 (2) or 14, does not imply acceptance of any ground on which the termination was requested. This provision, precluding any inference as to the validity of the grounds, is designed to facilitate such withdrawal or consent in order to prevent lengthy controversies.

2. The provision is presented in a separate article since it relates to two different articles. If retained in this form, it might be given the following heading: "No inference of validity of grounds".

* * *

Article 15. *Appointment of substitute arbitrator*

Where the mandate of an arbitrator terminates under article 13 or 14 or because of his withdrawal from office for any other reason or because of the revocation of his mandate by agreement of the parties or in any other case of termination of his mandate, a substitute arbitrator shall be appointed according to the rules that were applicable to the appointment of the arbitrator being replaced, unless the parties agree otherwise.

References

- A/CN.9/216, para. 50
A/CN.9/232, paras. 70-72
A/CN.9/233, paras. 118-120
A/CN.9/245, paras. 217-219
A/CN.9/246, paras. 42-48

⁴⁹See commentary to article 15, paras. 1-3.

Commentary

Further cases of termination of mandate

1. Article 15 deals primarily with the question how a substitute arbitrator would be appointed. Yet, in order to embrace all possible cases where such a need may arise, it deals, in a less conspicuous manner, also with those manifold situations of termination of mandate which are not covered by articles 13 and 14.

2. The two most important instances added here are the arbitrator's withdrawal from his office "for any reason" (other than the ones covered by articles 13 and 14) and the revocation of the mandate by agreement of the parties. The latter instance, i.e. removal of an arbitrator by consent of the parties, seems to be justifiedly included in view of the consensual nature of arbitration, which gives the parties unrestricted freedom to agree on the termination of the mandate of an arbitrator.

3. Inclusion of the first instance, however, is less easily justified and may, for example, be objected to on the ground that a person who had accepted to act as an arbitrator should not be allowed to resign for capricious reasons. Nevertheless, it is impractical to require just cause for the resignation (or to attempt to list all possible causes justifying resignation) since an unwilling arbitrator could not, in fact, be forced to perform his functions.⁵⁰ It should be noted, in respect of both above instances, that the Model Law does not deal with the legal responsibility of an arbitrator or other issues pertaining to the contractual party-arbitrator relationship.

Rules of appointing substitute arbitrator

4. Whenever a substitute arbitrator needs to be appointed, this shall be done in accordance with the rules that were applicable to the appointment of the arbitrator being replaced, whether these rules are laid down in the arbitration agreement or, as suppletive rules, in the Model Law.

5. This provision is non-mandatory, as is clear from the words "unless the parties agree otherwise". Such agreement would normally set forth a new appointment procedure for replacing an arbitrator whose mandate has terminated.⁵¹ Yet, it might relate to the preliminary question whether a substitute arbitrator should be appointed at all. For example, where the parties named a specific sole arbitrator in their original agreement,

⁵⁰Cf. A/CN.9/246, para. 44.

⁵¹For example, the parties could in their arbitration agreement include a stipulation intended to eliminate the possible danger that, in the case of a party-appointed arbitrator, the mechanism of resignation and replacement under article 15, in particular by using it repeatedly, could be abused for the purposes of obstructing the proceedings. This concern—which the Working Group, without denying its validity, decided not to deal with (A/CN.9/245, para. 19) could be met by a stipulation, inspired by article 56 (3) of the 1965 Washington Convention, to the effect that a party-appointed arbitrator who resigns without the consent of the arbitral tribunal (i.e. the other two members) would not be replaced by another party-appointed arbitrator but by one who would be appointed by either the third arbitrator (chairman) or a specified appointing authority.

they may wish not to continue the arbitral proceedings without him.

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CHAPTER IV. JURISDICTION OF ARBITRAL TRIBUNAL

Article 16. Competence to rule on own jurisdiction

(1) The arbitral tribunal has the power to rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause.

(2) A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence. A party is not precluded from raising such a plea by the fact that he has appointed, or participated in the appointment of, an arbitrator. A plea that the arbitral tribunal is exceeding the scope of its authority shall be raised promptly after the arbitral tribunal has indicated its intention to decide on the matter alleged to be beyond the scope of its authority. The arbitral tribunal may, in either case, admit a later plea if it considers the delay justified.

(3) The arbitral tribunal may rule on a plea referred to in paragraph (2) of this article either as a preliminary question or in an award on the merits. In either case, a ruling by the arbitral tribunal that it has jurisdiction may be contested by any party only in an action for setting aside the arbitral award.

References

- A/CN.9/216, paras. 34, 81-83
- A/CN.9/232, paras. 47-48, 146-150, 152-157
- A/CN.9/245, paras. 58-65
- A/CN.9/246, paras. 49-52, 54-56

Commentary

A. "Kompetenz-Kompetenz" and separability doctrine, paragraph (1)

1. Article 16 adopts the important principle that it is initially and primarily for the arbitral tribunal itself to determine whether it has jurisdiction, subject to ultimate court control (see below, paras. 12-14). Paragraph (1) grants the arbitral tribunal the power to rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. This power, often referred to as *Kompetenz-Kompetenz*, is an essential and widely accepted feature of modern international arbitration but, at present, is not yet recognized in all national laws.

2. The same is true with regard to the second principle adopted in article 16 (1), i.e. the doctrine of separability (or autonomy) of the arbitration clause. This doctrine complements the power of the arbitral tribunal to determine its own jurisdiction in that it calls for treating such a clause as an agreement independent of the other terms of the contract. A finding by the arbitral tribunal that the contract is null and void, therefore, does not require the conclusion that the arbitration clause is invalid. The arbitral tribunal would, thus, not lack jurisdiction to decide on the nullity of the contract (and on further issues submitted to it) unless it finds that the defect which causes the nullity of the contract affects also the arbitration clause itself. It may be mentioned that the principle of separability as adopted in article 16 (1), in contrast to some national laws which distinguish in this respect between initial defects and later grounds of nullity, applies whatever the nature of the defect.

3. Article 16 does not state according to which law the arbitral tribunal would determine the various possible issues relating to its jurisdiction. It is submitted that the applicable law should be the same as that which the Court specified in article 6 would apply in setting aside proceedings under article 34, since these proceedings constitute the ultimate court control over the arbitral tribunal's decision (article 16 (3)). This would mean that the capacity of the parties and the validity of the arbitration agreement would be decided according to the law determined pursuant to the rules contained in article 34 (2) (a) (i) and that the question of arbitrability and other issues of public policy would be governed by the law of "this State" (see present text of article 34 (2) (b)).⁵² As regards these latter issues, including arbitrability, it is further submitted that the arbitral tribunal, like the Court under article 34 (2) (b), should make a determination *ex officio*, i.e. even without any plea by a party, as referred to in article 16 (2).⁵³

B. Time-limits for raising objections, paragraph (2)

4. Paragraph (2) deals with the possible plea of a party that the arbitral tribunal does not have jurisdiction to decide the case before it or that it is exceeding the scope of its authority. It aims, in particular, at ensuring that any such objections are raised without delay.

5. The respondent may not invoke lack of jurisdiction after submitting his statement of defence (as referred to in article 23 (1)) unless the arbitral tribunal admits a later plea since it considers the delay justified. With respect to a counter-claim, which is no longer dealt with expressly in the text,⁵⁴ the relevant cut-off point

⁵²As regards subparagraph (i), the reference to the law of "this State" is tentative and controversial; see commentary to article 34, para. 12.

⁵³If the Commission accepts this interpretation, it may wish to consider expressing this understanding in the text of article 16, possibly combined with a provision on the effect, and its limits, of a waiver or submission, as discussed below, paras. 8-10.

⁵⁴The Working Group, at its seventh session, decided to delete, at the end of the first sentence of article 16 (2), the words "or, with respect to a counter-claim, in the reply to the counter-claim", on the understanding that any provisions of the Model Law referring to the claim would apply, *mutatis mutandis*, to a counter-claim (A/CN.9/246, para. 196).

would be the time at which the claimant submits his reply thereto.

6. As stated in the second sentence of paragraph (2), the respondent is not precluded from invoking lack of jurisdiction by the fact that he has appointed, or participated in the appointment of, an arbitrator. Thus, if, despite his objections, he prefers not to remain passive but to take part in, and exert influence on, the constitution of the arbitral tribunal, which would eventually rule on his objections, he need not make a reservation, as would be necessary under some national laws for excluding the effect of waiver or submission.

7. The second type of plea dealt with in paragraph (2), which is that the arbitral tribunal is exceeding the scope of its authority, must be raised promptly after the tribunal has indicated its intention to decide on the matter alleged to be beyond the scope of its authority; here again, a later plea may be admitted if the arbitral tribunal considers the delay to be justified. While any instance of the arbitral tribunal's exceeding its authority may often occur or become certain only in the context of the award or other decision, the above time-limit would be relevant and useful in those cases where there are clear indications at an earlier stage, for example, where the arbitral tribunal requests evidence relating to an issue not submitted to it.

C. *Effect of failure to raise plea*

8. The Model Law does not state whether a party's failure to raise his objections within the time-limit set by article 16 (2) has effect at the post-award stage. The pertinent observation of the Working Group was that a party who failed to raise the plea as required under article 16 (2) should be precluded from raising such objections not only during the later stages of the arbitral proceedings but also in other contexts, in particular, in setting aside proceedings or enforcement proceedings, subject to certain limits such as public policy, including those relating to arbitrability.⁵⁵

9. It is submitted that this observation accords with the purpose underlying paragraph (2) and might appropriately be expressed in the Model Law.⁵⁶ It would mean, in practical terms, that any objection, for example to the validity of the arbitration agreement, may not later be invoked as a ground for setting aside under article 34 (2) (a) (i), or for requesting, under article 36 (1) (a) (i), refusal of recognition or enforcement of an award (made under this Law); these provisions on grounds for setting aside or refusing recognition or enforcement would remain applicable and of practical relevance to those cases where a party raised the plea in time but without success or where a party did not participate in the arbitration, at least not

submit a statement or take part in hearings on the substance of the dispute.

10. As expressed in the above observation of the Working Group, there are limits to the effect of a party's failure to raise his objections. These limits arise from the fact that certain defects such as violation of public policy, including non-arbitrability, cannot be cured by submission to the proceedings. Accordingly, such grounds for lack of jurisdiction would be decided upon by a court in accordance with article 34 (2) (b) or, as regards awards made under this Law, article 36 (1) (b) even if no party had raised any objections in this respect during the arbitral proceedings. It may be added that this result is in harmony with the understanding (stated above, para. 3) that these latter issues are to be determined by the arbitral tribunal *ex officio*.

D. *Ruling by arbitral tribunal and judicial control, paragraph (3)*

11. Objections to the arbitral tribunal's jurisdiction go to the very foundation of the arbitration. Jurisdictional questions are, thus, antecedent to matters of substance and usually ruled upon first in a separate decision in order to avoid possible waste of time and costs. However, in some cases, in particular where the question of jurisdiction is intertwined with the substantive issue, it may be appropriate to combine the ruling on jurisdiction with a partial or complete decision on the merits of the case. Article 16 (3) therefore grants the arbitral tribunal discretion to rule on a plea referred to in paragraph (2) either as a preliminary question or in an award on the merits.

12. As noted earlier (above, para. 1), the power of the arbitral tribunal to rule on its own competence is subject to judicial control. Where a ruling by the arbitral tribunal that it has jurisdiction is, exceptionally, included in an award on the merits, it is obvious that the judicial control of that ruling would be exercised upon an application by the objecting party for the setting aside of that award. The less clear, and in fact controversial, case is where such affirmative ruling is made on a plea as a preliminary question. The solution adopted in article 16 (3) is that also in this case judicial control may be sought only after the award on the merits is rendered, namely in setting-aside proceedings (and, although this is not immediately clear from the present text,⁵⁷ in any recognition or enforcement proceedings).

13. It was for the purpose of preventing dilatory tactics and abuse of any immediate right to appeal that this solution was adopted, reinforced by the deletion of previous draft article 17, which provided for concurrent

⁵⁵A/CN.9/246, para. 51.

⁵⁶This understanding would also be in line with the one accepted by the Working Group on the effect of a waiver under article 4, concerning non-compliance with a non-mandatory provision of the Model Law or a clause of the arbitration agreement (see commentary to article 4, para. 6).

⁵⁷The reason for referring in article 16 (3) only to the application for setting aside was that the thrust of this provision concerns the faculty of an objecting party to attack the arbitral tribunal's ruling by initiating court proceedings for review of that ruling. However, the Commission may wish to consider the appropriateness of adding, for the sake of clarity, a reference to recognition or enforcement proceedings, which, although initiated by the other party, provide a forum for the objecting party to invoke lack of jurisdiction as a ground for refusal (under article 36 (1) (a) (i)).

court control.⁵⁸ The disadvantage of this solution, as was pointed out by the proponents of immediate court control, is that it may lead to considerable waste of time and money where, after lengthy proceedings with expensive hearings and taking of evidence, the Court sets aside the award for lack of jurisdiction.

14. It is submitted that the weight of these two conflicting concerns, i.e. fear of dilatory tactics and obstruction versus waste of time and money, is difficult to assess at a general level imagining all possible cases. It seems that the assessment could better be made with respect to each particular case. Thus, it may be worth considering giving the arbitral tribunal discretion, based on its assessment of the actual potential of these concerns, to cast its ruling in the form either of an award, which would be subject to instant court control,⁵⁹ or of a procedural decision, which may be contested only in an action for setting aside the later award on the merits. In considering this suggestion, which would help to avoid the present inconsistency between article 16 (3) and article 13 (3), thought may be given to adopting the special elements of article 13 (3) designed to minimize the risk of dilatory tactics, i.e. short time-limit for resort to court, finality of court decision and discretion of arbitral tribunal to continue proceedings.

15. Article 16 (3) does not regulate the case where the arbitral tribunal rules that it has no jurisdiction. A previous draft provision which allowed recourse to the court, not necessarily with the aim of forcing the arbitrators to continue the proceedings but in order to obtain a decision on the existence of a valid arbitration agreement, was not retained by the Working Group.⁶⁰ It was stated that such ruling of the arbitral tribunal was final and binding as regards these arbitral proceedings but did not settle the question whether the substantive claim was to be decided by a court or by an arbitral tribunal. It is submitted that it thus depends on the general law on arbitration or civil procedure whether court control on such ruling may be sought, other than by way of request in any substantive proceedings as referred to in article 8 (1).

* * *

⁵⁸A/CN.9/246 paras. 52-56. The text of article 17, which covered not only the case of article 16 (3), i.e. ruling of arbitral tribunal affirming its jurisdiction, was as follows:

"Article 17. *Concurrent court control*

"(1) [Notwithstanding the provisions of article 16.] a party may [at any time] request the Court specified in article 6 to decide whether a valid arbitration agreement exists and [if arbitral proceedings have commenced,] whether the arbitral tribunal has jurisdiction [with regard to the dispute referred to it].

"(2) While such issue is pending with the Court, the arbitral tribunal may continue the proceedings [unless the Court orders a stay of the arbitral proceedings]."

⁵⁹It may be noted that the present solution in article 16 (3) does not give the arbitral tribunal that option, irrespective of whether a ruling on jurisdiction would be classified as an "award"; as to the desirability of including in the Model Law a definition of "award", see commentary to article 34, para. 3.

⁶⁰A/CN.9/245, paras. 62-64. The deleted provision read as follows: "A ruling by the arbitral tribunal that it has no jurisdiction may be contested by any party within 30 days before the Court specified in article [6]".

Article 18. *Power of arbitral tribunal to order interim measures*

Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute. The arbitral tribunal may require any party to provide security for the costs of such measure.

References

- A/CN.9/216, paras. 65-69
- A/CN.9/232, paras. 119-123
- A/CN.9/245, paras. 70-72
- A/CN.9/246, paras. 57-59

Commentary

1. According to article 18, the arbitral tribunal has the implied power, unless excluded by agreement of the parties, to order any party to take such interim measure of protection as the arbitral tribunal considers necessary in respect of the subject-matter of the dispute. The general purpose of such order would be to prevent or minimize any disadvantage which may be due to the duration of the arbitral proceedings until the final settlement of the dispute and the implementation of its result.

2. Practical examples of interim measures designed to prevent or mitigate loss include the preservation, custody or sale of goods which are the subject-matter of the dispute. However, article 18 is not limited to sales transactions and would, for example, cover measures designed provisionally to determine and "stabilize" the relationship of the parties in a long-term project. Examples of such *modus vivendi* orders include the use or maintenance of machines or works or the continuation of a certain phase of a construction if necessary to prevent irreparable harm. Finally, an order may serve the purpose of securing evidence which would otherwise be unavailable at a later stage of the proceedings.

3. As is clear from the text of article 18, the interim measure must relate to the subject-matter of the dispute and the order may be addressed only to a party (or both parties). This restriction, which follows from the fact that the arbitral tribunal derives its jurisdiction from the arbitration agreement, constitutes one of the main factors narrowing the scope of article 18 as compared with the considerably wider range of court measures envisaged under article 9.⁶¹

4. Another major difference is that article 18 neither grants the arbitral tribunal the power to enforce its orders nor provides for judicial enforcement of such orders of the arbitral tribunal; an earlier draft provision envisaging court assistance in this respect was not retained by the Working Group. Nevertheless, it was understood that a State would not be precluded from

⁶¹See commentary to article 9, paras. 4-5.

rendering such assistance under its procedural law,⁶² whether by providing judicial enforcement or by empowering the arbitral tribunal to take certain measures of compulsion.

5. Yet, even without such possibility of enforcement, the power of the arbitral tribunal under article 18 is of practical value. It seems probable that a party will comply with the order and take the measure considered necessary by the arbitrators who, after all, will be the ones to decide the case. This probability may be increased by the use of the power to require any party to provide security for the costs of such measure, in particular where the arbitral tribunal would order the other party to provide such security, which, it is submitted, may also cover any possible damages. Finally, if a party does not take the interim measure of protection as ordered by the arbitral tribunal, such failure may be taken into account in the final decision, in particular in any assessment of damages.

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CHAPTER V. CONDUCT OF ARBITRAL PROCEEDINGS

Article 19. *Determination of rules of procedure*

(1) Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings.

(2) Failing such agreement, the arbitral tribunal may, subject to the provisions of this Law, conduct the arbitration in such manner as it considers appropriate. The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance, materiality and weight of any evidence.

(3) In either case, the parties shall be treated with equality and each party shall be given a full opportunity of presenting his case.

References

- A/CN.9/216, para. 56
- A/CN.9/232, paras. 101-106
- A/CN.9/245, paras. 73-75
- A/CN.9/246, paras. 60-63

Commentary

"Magna Carta of Arbitral Procedure"

1. Article 19 may be regarded as the most important provision of the Model Law. It goes a long way towards establishing procedural autonomy by recognizing the parties' freedom to lay down the rules of procedure (paragraph (1)) and by granting the arbitral tribunal, failing agreement of the parties, wide discretion as to how to conduct the proceedings (paragraph (2)), both

subject to fundamental principles of fairness (paragraph (3)). Taken together with the other provisions on arbitral procedure, a liberal framework is provided to suit the great variety of needs and circumstances of international cases, unimpeded by local peculiarities and traditional standards which may be found in the existing domestic law of the place.

Freedom of parties to lay down procedural rules, paragraph (1)

2. Paragraph (1) guarantees the freedom of the parties to determine the rules on how their chosen method of dispute settlement will be implemented. This allows them to tailor the rules according to their specific needs and wishes. They may do so by preparing their own individual set of rules or, as clarified in article 2 (d), by referring to standard rules for institutional (supervised or administered) arbitration or for pure *ad hoc* arbitration. The parties may, thus, take full advantage of the services of permanent arbitral institutions or of established arbitration practices of trade associations. They may choose those features familiar to them and even opt for a procedure which is anchored in a particular legal system. However, if they refer to a given law on civil procedure, including evidence, such law would be applicable by virtue of their choice and not by virtue of being the national law.

3. The freedom of the parties is subject only to the provisions of the Model Law, that is, to its mandatory provisions. The most fundamental of such provisions, from which the parties may not derogate, is the one contained in paragraph (3). Other such provisions concerning the conduct of the proceedings or the making of the award are contained in articles 23 (1), 24 (2)-(4), 27, 30 (2), 31 (1), (3), (4), 32 and 33 (1), (2), (4), (5).

Procedural discretion of arbitral tribunal, paragraph (2)

4. Where the parties have not agreed, before or during the arbitral proceedings,⁶³ on the procedure (i.e. at least not on the particular matter at issue), the arbitral tribunal is empowered to conduct the arbitration in such manner as it considers appropriate, subject only to the provisions of the Model Law, which often set forth special features of the discretionary powers (e.g. articles 23 (2), 24 (1), (2), 25) and sometimes limit the discretion to ensure fairness (e.g. articles 19 (3), 24 (3), (4), 26 (2)). As stated in paragraph (2), this power includes the power to determine the admissibility, relevance, materiality and weight of any evidence.⁶⁴ This, in turn,

⁶³As was noted by the Working Group, the freedom of the parties under paragraph (1) to agree on the procedure is a continuing one throughout the arbitral proceedings and not limited, for example, to the time before the first arbitrator is appointed (A/CN.9/246, para. 63). It is submitted, however, that the parties themselves may in their original agreement limit their freedom in this way if they wish their arbitrators to know from the start under what procedural rules they are expected to act.

⁶⁴Not regulated in article 16 (or any other provision of the Model Law) is the question of which party bears the burden of proof, which is, for example, answered in article 24 (1) of the UNCITRAL Arbitration Rules as follows: "Each party shall have the burden of proving the facts relied on to support his claim or defence".

⁶²A/CN.9/245, para. 72.

includes the power of the arbitral tribunal to adopt its own rules of evidence, although that is no longer expressed in the text.

5. Except where the parties have laid down detailed and stringent rules of procedure, including evidence, the discretionary powers of the arbitral tribunal are considerable in view of the fact that the Model Law, with its few provisions limiting the procedural discretion, provides a liberal framework. This enables the arbitral tribunal to meet the needs of the particular case and to select the most suitable procedure when organizing the arbitration, conducting individual hearings or other meetings and determining the important specifics of taking and evaluating evidence.

6. In practical terms, the arbitrators would be able to adopt the procedural features familiar, or at least acceptable, to the parties (and to them). For example, where both parties are from a common law system, the arbitral tribunal may rely on affidavits and order pre-hearing discovery to a greater extent than in a case with parties of civil law tradition, where, to mention another example, the mode of proceedings could be more inquisitorial than adversarial. Above all, where the parties are from different legal systems, the arbitral tribunal may use a liberal "mixed" procedure, adopting suitable features from different legal systems and relying on techniques proven in international practice, and, for instance, let parties present their case as they themselves judge best. Such procedural discretion in all these cases seems conducive to facilitating international commercial arbitration, while being forced to apply the "law of the land" where the arbitration happens to take place would present a major disadvantage to any party not used to that particular and possibly peculiar system of procedure and evidence.

Fundamental requirements of fairness, paragraph (3)

7. Paragraph (3) adopts basic notions of fairness in requiring that the parties be treated with equality and each party be given a full opportunity of presenting his case. As expressed by the words "in either case", these fundamental requirements shall be complied with not only by the arbitral tribunal when using its discretionary powers under paragraph (2) but also by the parties when using their freedom under paragraph (1) to lay down the rules of procedure. It is submitted that these principles, in view of their fundamental nature, are to be followed in all procedural contexts, including, for example, the procedures referred to in articles 13 and 14.

8. The principles which paragraph (3) states in a general manner are implemented and put in more concrete form by provisions such as articles 24 (3), (4) and 26 (2).⁶⁵ Other provisions, such as articles 16 (2), 23 (2) and 25 (c), present certain refinements or

restrictions in specific procedural contexts in order to ensure efficient and expedient proceedings. These latter provisions, which like all other provisions of the Model Law are in harmony with the principles laid down in article 19 (3), make it clear that "full opportunity of presenting one's case" does not entitle a party to obstruct the proceedings by dilatory tactics and, for example, present any objections, amendments, or evidence only on the eve of the award.

9. Of course, the arbitral tribunal must be guided, and indeed abide, by this principle when determining the appropriate conduct of the proceedings, for example, when fixing time-limits for submission of statements or evidence or when establishing the modalities of hearings. It must, for instance, not require more from a party than what may be reasonably expected under the circumstances. With regard to the observation of the Working Group noted in the commentary to article 12 (para. 5), it might be doubted whether a party is given a full opportunity of presenting his case where, although he is able to state in full his claim and the evidence supporting it, the conduct of an arbitrator reveals clearly lack of competence or of another qualification required of him by agreement of the parties.

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Article 20. Place of arbitration

(1) The parties are free to agree on the place of arbitration. Failing such agreement, the place of arbitration shall be determined by the arbitral tribunal.

(2) Notwithstanding the provisions of paragraph (1) of this article, the arbitral tribunal may, unless otherwise agreed by the parties, meet at any place it considers appropriate for consultation among its members, for hearing witnesses, experts or the parties, or for inspection of goods, other property, or documents.

References

- A/CN.9/216, paras. 53-55
- A/CN.9/232, paras. 99-100, 112-113
- A/CN.9/245, paras. 76-79
- A/CN.9/246, paras. 64-65

Commentary

Determination of place of arbitration, paragraph (1)

1. Paragraph (1) recognizes the freedom of the parties to agree on the place of arbitration. The parties may either themselves determine that place or, as is clear from article 2 (c), authorize a third party, including an institution, to make that determination. Failing any such agreement, the place of arbitration shall be determined by the arbitral tribunal.

2. The place of arbitration is of legal relevance in three respects. First, it is one of the various possible

⁶⁵Another example would be article 24 (2), although there may be some doubt whether this provision as presently drafted fully implements and accords with the requirement that each party shall be given a full opportunity of presenting his case (see commentary to article 24, para. 4).

factors establishing the international character of the arbitration, provided it is determined in, or pursuant to, the arbitration agreement (article 1 (2) (b) (i)). Second, it is a connecting factor for the "territorial" applicability of the Model Law, either as exclusive criterion, if the Commission adopts the view prevailing in the Working Group, or as subsidiary connecting factor, if the Model Law would in its final form allow the parties to select a procedural law other than that of the State where the arbitration is held.⁶⁶ Third, the place of arbitration is, by virtue of article 31 (3), the place of origin of the award and as such relevant in the context of recognition or enforcement proceedings, in particular, by determining, for the purposes of article 36 (1) (a) (v), "the country in which . . . that award was made".

Meeting at place other than place of arbitration, paragraph (2)

3. The factual significance of the place of arbitration, in particular when determined by the parties themselves, is that, in principle, the arbitral proceedings, including any hearings or other meetings, would be expected to be held at that place. However, there may be good reasons for meeting elsewhere, not merely in the case where a change of locale is necessary (e.g. for purposes of inspection of premises). For example, where witnesses are to be heard or where the arbitrators meet among themselves for consultations, another place may be more appropriate for the sake of convenience of the persons involved and for keeping down the costs of the arbitration. Yet another of the many possible considerations would be to balance the parties' own expenses by scheduling some of the meetings at the place of one party and some of the meetings at the place of the other party.

4. For all such purposes, paragraph (2) empowers the arbitral tribunal, unless otherwise agreed by the parties, to meet at any place it considers appropriate for consultation among its members, for hearing witnesses, experts or (only) the parties, or for inspection of goods, other property, or documents.

* * *

Article 21. Commencement of arbitral proceedings

Unless otherwise agreed by the parties, the arbitral proceedings in respect of a particular dispute commence on the date on which a request for that dispute to be referred to arbitration is received by the respondent.

References

- A/CN.9/233, paras. 21-23
- A/CN.9/245, paras. 24-27
- A/CN.9/246, paras. 66-67

Commentary

1. Article 21 provides a rule for determining the point of time at which the arbitral proceedings in respect of a

particular dispute commence. Such determination is relevant not only for the purposes of the Model Law itself but also for legal consequences regulated in other laws, e.g. cessation or interruption of any limitation period.

2. The relevant point of time is the date on which a request for the particular dispute to be referred to arbitration is received by the respondent.⁶⁷ Such request, whether in fact called "request", "notice", "application" or "statement of claim", must identify the particular dispute and make clear that arbitration is resorted to thereby and not, for example, indicate merely the intention of later initiating arbitral proceedings.

3. As stated in the text, the parties may derogate from this provision and select a different point of time. To take an example which is not uncommon in institutional arbitration, they may agree, by reference to the institutional rules, that the relevant date is the one on which the request for arbitration is received by the arbitral institution.

* * *

Article 22. Language

(1) The parties are free to agree on the language or languages to be used in the arbitral proceedings. Failing such agreement, the arbitral tribunal shall determine the language or languages to be used in the proceedings. This agreement or determination, unless otherwise specified therein, shall apply to any written statement by a party, any hearing and any award, decision or other communication by the arbitral tribunal.

(2) The arbitral tribunal may order that any documentary evidence shall be accompanied by a translation into the language or languages agreed upon by the parties or determined by the arbitral tribunal.

References

- A/CN.9/233, paras. 27-30
- A/CN.9/245, paras. 34-36
- A/CN.9/246, paras. 68-70

Commentary

1. Article 22 deals with an issue which, while not commonly dealt with in national laws on arbitration, is of considerable practical importance in international commercial arbitration, i.e. the determination of the language or languages to be used in the arbitral proceedings. It is clear from this provision, if there ever could be any doubt on this point, that the arbitral proceedings are not subject to any local language requirement, for example, any "official" language or languages for court proceedings at the place of arbitration.

⁶⁶See remarks on the territorial scope of application of the Model Law in commentary to article 1, paras. 4-6.

⁶⁷As to what constitutes "receipt" and when a communication is received or deemed to be received, see article 2 (e).

2. According to paragraph (1), it is primarily for the parties to determine the language or languages of the arbitral proceedings. Autonomy of the parties is particularly important here since such determination affects their position in the proceedings and the expediency and costs of the arbitration. They are in the best position to judge, for example, whether a single language would be feasible and acceptable or, if more than one language need be used, which languages they should be. An agreement by the parties would have the advantage of providing certainty on that point from the start. It would also assist in selecting suitable arbitrators and save the arbitrators, upon their appointment, from having to make a procedural decision, which in practice often turns out to be a rather delicate one.

3. Where the parties have not settled the language question, the arbitral tribunal will make that determination in accordance with paragraph (1). In doing so, it will take into account the factors mentioned above and the language capabilities of the arbitrators themselves. Above all, it must comply with the fundamental principles laid down in article 19 (3).

4. However, it is submitted, these principles do not necessarily mean that the language of each party must be adopted as a language "to be used in the arbitral proceedings". For instance, where parties have used only one language in their business dealings, in particular in their contract and their correspondence, a decision by the arbitral tribunal to conduct the proceedings in this language would not *per se* conflict with the principle of equal treatment of the parties or deprive that party whose language is not adopted of having a full opportunity of presenting his case. That party may, in fact, use his language in any hearing or other meeting but he must arrange, or at least pay, for the interpretation into the language of the proceedings. As this example may show, the determination of the language or languages to be used is, to a certain degree, a decision on costs. To use the opposite example, in the case of proceedings with two languages, any cost for interpretation or translation between the two languages would form part of the overall costs of the arbitration and as such be borne in principle by the unsuccessful party (cf., e.g. article 40 (1) of the UNCITRAL Arbitration Rules).

5. Article 22 indicates the scope of the determination of the language or languages by listing those items which must be in such language, i.e. any written statement by a party, any hearing and any award, decision or other communication by the arbitral tribunal. Yet, the parties or the arbitrators may determine the scope differently. As regards documentary evidence, paragraph (2) leaves it to the arbitral tribunal to decide whether and to what extent translation into the language of the proceedings is required. This discretion is appropriate in view of the fact that such documents may be voluminous and only in part truly relevant to the dispute.

Article 23. *Statements of claim and defence*

(1) Within the period of time agreed by the parties or determined by the arbitral tribunal, the claimant shall state the facts supporting his claim, the points at issue and the relief or remedy sought, and the respondent shall state his defence in respect of these particulars. The parties may annex to their statements all documents they consider to be relevant or may add a reference to the documents or other evidence they will submit.

(2) Unless otherwise agreed by the parties, either party may amend or supplement his claim or defence during the course of the arbitral proceedings, unless the arbitral tribunal considers it inappropriate to allow such amendment having regard to the delay in making it or prejudice to the other party or any other circumstances.

References

A/CN.9/233, paras. 24-26

A/CN.9/245, paras. 29-30, 33

A/CN.9/246, paras. 71-73

Commentary

Essential contents of statement of claim or defence, paragraph (1)

1. Paragraph (1) deals with the preparation of the case in writing. The first sentence sets forth those elements of the initial pleadings which are essential for defining the dispute on which the arbitral tribunal is to give a decision. It is then up to the arbitral tribunal to require further statements or explanations, under its general power of article 19 (2). The required contents of the initial statement of claim and of the respondent's reply may be regarded as so basic and necessary as to conform with all established arbitration systems and rules. It is in this spirit that the provision does not go into particulars such as to whom the statements must be addressed.⁶⁸

2. Nevertheless, it is submitted that the provision should be non-mandatory, at least as regards its details. For example, arbitration rules may describe these essential contents in slightly different form or may require their inclusion already in the initial request for arbitration, in which case the reference in paragraph (1) to the period of time would be obsolete.

3. The second sentence of paragraph (1) leaves it to each party, and his procedural strategy, whether to submit all relevant documents or at least refer to the documents or other evidence at this stage. While these documents or listing of evidence are, thus, not part of the essential contents of the initial pleadings, the parties are not fully at liberty to select the point of time for revealing or submitting the documents or other evidence

⁶⁸Article 24 (4) ensures that any statement submitted to the arbitral tribunal would be communicated to the other party.

they intend to rely on. Unless specific provision is made in the arbitration agreement, the arbitral tribunal may, in its general discretion under article 19 (2), require a party to submit a summary of the documents and other evidence which that party intends to present in support of his claim or defence and, as is clear from article 25 (c), require a party to produce documents, exhibits or other evidence within a certain period of time.

Amending or supplementing the claim or defence, paragraph (2)

4. Paragraph (2) leaves it to the discretion of the arbitral tribunal to determine, on the basis of certain criteria, whether a party may amend or supplement his statement of claim or defence. One major criterion would be the extent and the reason for the delay in making the amendment (or supplement⁶⁹). Another criterion would be prejudice to the other party, i.e. procedural prejudice (such as upsetting the normal course of the proceedings or unduly delaying the final settlement of the dispute as defined in the initial pleadings). Yet, since there may be further reasons which would make it inappropriate to allow any later amendment, the arbitral tribunal may, under paragraph (2), take into account "any other circumstances".

5. However, there is one important point in respect of which the arbitral tribunal has no discretion at all: The amendment or supplement must not exceed the scope of the arbitration agreement. This restriction, while not expressed in the article, seems self-evident in view of the fact that the jurisdiction of the arbitral tribunal is based on, and given within the limits of, that agreement.

6. Paragraph (2), as stated therein, is non-mandatory. The parties may, thus, derogate therefrom and provide, for example, that amendments are generally prohibited or that they are allowed as a matter of right or that they are subject to specified limits.

Analogous application to counter-claim and set-off

7. As noted earlier,⁷⁰ the Model Law no longer refers expressly to counter-claims, but any provision referring to the claim would apply, *mutatis mutandis*, to a counter-claim. Thus, paragraph (1) would provide, by analogy, that the respondent shall state the facts supporting his counter-claim, the points at issue and the relief or remedy sought, and that he may annex all documents he considers to be relevant or may add a reference to the documents or other evidence he will submit in support of his counter-claim. It is submitted that the same would apply to a claim relied on by the respondent for the purpose of a set-off.

8. As regards paragraph (2), the analogy takes two forms. The first is a true analogy with the claim, that is, the respondent may amend or supplement his counter-claim unless the arbitral tribunal considers it inappropriate to allow such amendment for any of the reasons

listed in paragraph (2). The second, and more fundamental, issue covered by analogy is whether the respondent is allowed to "amend or supplement" his statement of defence by bringing at a later stage a counter-claim or a claim for the purpose of a set-off. It may be noted that in both cases the above restriction to the scope of the arbitration agreement applies.

* * *

Article 24. Hearings and written proceedings

(1) Subject to any contrary agreement by the parties, the arbitral tribunal shall decide whether to hold oral hearings or whether the proceedings shall be conducted on the basis of documents and other materials.

(2) Notwithstanding the provisions of paragraph (1) of this article, if a party so requests, the arbitral tribunal may, at any appropriate stage of the proceedings, hold hearings for the presentation of evidence or for oral argument.

(3) The parties shall be given sufficient advance notice of any hearing and of any meeting of the arbitral tribunal for inspection purposes.

(4) All statements, documents or other information supplied to the arbitral tribunal by one party shall be communicated to the other party. Also any expert report or other document, on which the arbitral tribunal may rely in making its decision, shall be communicated to the parties.

References

- A/CN.9/216, para. 57
- A/CN.9/232, paras. 107-111, 113
- A/CN.9/245, paras. 80-83
- A/CN.9/246, paras. 74-80

Commentary

Proceedings with or without oral hearing, paragraphs (1) and (2)

1. Paragraphs (1) and (2) deal with the important procedural question whether there will be any oral hearing or whether, as is less common, the arbitral proceedings will be conducted exclusively on the basis of documents and other materials (i.e. as "written proceedings"). Under paragraph (1), the arbitral tribunal shall decide that question,⁷¹ subject to any contrary agreement by the parties and subject to paragraph (2), which should, thus, be commented upon together with paragraph (1). In order to facilitate understanding the inter-play of these two paragraphs, it seems advisable to distinguish three situations.

⁶⁹The word "amendment" was intended by the drafting group to include "supplement".

⁷⁰Commentary to article 16, para. 5, and footnote 54.

⁷¹As a practical matter, "decision" does not mean that the arbitral tribunal would have to render a "decree" on this question at an early stage with binding effect for the whole proceedings. What is meant is a continuing discretion to determine in the light of the development of the case whether an oral hearing is needed or at least desirable.

arbitral proceedings held under the Model Law.⁷⁹ This limitation is the result of a compromise between those in favour of international court assistance and those opposed to any provision on court assistance.⁸⁰

Request for assistance, paragraph (1), and its execution, paragraph (2)

5. According to paragraph (1), assistance would be rendered by a "competent court" which is not necessarily the one designated pursuant to article 6 since its competence may be based, for example, on the residence of the witness to be heard or the location of the property to be inspected. A request for court assistance may be made by the arbitral tribunal or by a party with the approval of the arbitral tribunal. Although the obtaining of evidence may be regarded as being strictly a matter for the parties, the involvement of the arbitral tribunal would be conducive to preventing dilatory tactics of a party. Paragraph (1) lists the required contents of the request, without going into further details of form or procedure.

6. Paragraph (2) implements the earlier mentioned "expectation" of court assistance, without interfering with established national rules on court competence and organization (see above, para. 2). The court may, within its competence and according to its rules on taking evidence, execute the request in either of the following ways: It may take the evidence itself (e.g. hear the witness, obtain the document or access to property and, unless the arbitrators and parties are present, communicate the results to the arbitral tribunal), or it may order that the evidence be provided directly to the arbitral tribunal, in which case the involvement of the court is limited to exerting compulsion.

* * *

CHAPTER VI. MAKING OF AWARD AND TERMINATION OF PROCEEDINGS

Article 28. *Rules applicable to substance of dispute*

(1) The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of laws rules.

(2) Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

⁷⁹A/CN.9/233, para. 36; A/CN.9/245, paras. 37, 42-46, A/CN.9/246, paras. 90-91, 95-96.

⁸⁰It was stated in this context that court assistance to foreign arbitral tribunals or assistance by foreign courts in taking evidence could not appropriately be dealt with in a model law, and it was suggested as a possible future item of work to be discussed by the Commission that it might be desirable to elaborate rules on international judicial assistance either in a separate convention or by extending an existing convention (A/CN.9/233, para. 37; A/CN.9/246, paras. 43-44).

(3) The arbitral tribunal shall decide *ex aequo et bono* or as *amiable compositeur* only if the parties have expressly authorized it to do so.

References

- A/CN.9/216, paras. 84-94
- A/CN.9/232, paras. 158-170
- A/CN.9/245, paras. 93-100
- A/CN.9/246, paras. 102-104

Commentary

1. Article 28 deals with the question of which law or rules the arbitral tribunal shall apply to the substance of the dispute. This question, which should be distinguished from the issue of the law applicable to the arbitral procedure or the arbitration agreement, is often dealt with in conventions and national laws devoted to private international law or conflict of laws. However, it is sometimes covered by national laws on arbitration and often by arbitration conventions and arbitration rules.

2. The Model Law follows this latter practice with a view to providing guidance on this important point and to meet the needs of international commercial arbitration. It adopts the same policy as in respect of procedural matters by granting the parties full autonomy to determine the issue (including the option of *amiable composition*) and, failing agreement, by entrusting the arbitral tribunal with that determination.

Parties' freedom to choose substantive "rules of law", paragraph (1)

3. The provision of paragraph (1) that the dispute shall be decided in accordance with such rules of law as are chosen by the parties is remarkable in two respects. The first one is the recognition or guarantee of the parties' autonomy as such, which is at present widely but not yet uniformly accepted. Article 28 (1) could enhance global acceptance and help to overcome existing restrictions such as substantial connection with the country of the chosen law.

4. The second one is the freedom to choose "rules of law" and not merely a "law", which could be understood as referring to the legal system of one particular State only. This provides the parties with a wider range of options and allows them, for example, to designate as applicable to their case rules of more than one legal system, including rules of law which have been elaborated on the international level.⁸¹ Adoption of this formula, to date only found in the 1965 Washington Convention (art. 42) and the recent international arbitration laws of France (art. 1496 new CPC) and

⁸¹As a further aid in interpreting the term "rules of law" and defining its limits, it may be reported that some representatives would have preferred an even wider interpretation or an even broader formula to include, for example, general legal principles or case law developed in arbitration awards but that this, in the view of the Working Group, was too far-reaching to be acceptable to many States, at least for the time being (A/CN.9/245, para. 94).

Djibouti (art. 12), constitutes a progressive step, designed to meet the needs and interests of parties to international commercial transactions. A useful rule of interpretation is added for those cases where the parties designate the law or legal system of a particular State.

Determination of substantive law by arbitral tribunal, paragraph (2)

5. Paragraph (2) reflects a more cautious approach in that it does not provide, as would be in line with paragraph (1), that the arbitral tribunal shall apply the rules of law it considers appropriate. Instead, it requires the arbitral tribunal to apply a conflict of laws rule, namely that which it considers applicable, in order to determine the law applicable to the substance of the dispute.

6. The resulting disparity may be regarded as acceptable in view of the fact that paragraph (1) is addressed to the parties who are free to take advantage of the wider scope, while paragraph (2) is addressed to the arbitral tribunal and applied only in the case where the parties have not made their choice. Incidentally, the parties could agree to widen the scope of the arbitral tribunal's determination, just as they are free to limit it, for example, by excluding one or more specified national laws. Above all, paragraph (2) deserves to be judged on its own. In this regard it seems worth noting that it is in full harmony with the 1961 Geneva Convention (art. VII (1)) and with widely used arbitration rules (art. 13 (3) ICC-Rules, art. 33 (1) UNCITRAL Arbitration Rules), which equally recognize the interests of the parties in having some degree of certainty as to which will be the law determined by the arbitral tribunal.

Express authorization of "amiable composition", paragraph (3)

7. Arbitration rules often provide that parties may authorize the arbitral tribunal to decide as *amiable compositeur* provided, however, that such arbitration is permitted by the law applicable to the arbitral procedure. Article 28 (3) grants this permission and, thus, gives effect to an express authorization by the parties that the arbitral tribunal shall decide *ex aequo et bono*, as this arbitration is labelled in some legal systems, or, as labelled in others, as *amiable compositeur*.

8. Although this type of arbitration is not known in all legal systems, its inclusion in the Model Law seems appropriate for the following reasons. It is sound policy to accommodate features and practices of arbitration even if familiar only to certain legal systems. This is reasonable not merely because it would be contrary to the purpose of the Model Law to disregard or even prevent established practices but because it is in harmony with the principle of reducing the importance of the place of arbitration by recognizing types of arbitration not normally used or known at that place. Finally, such recognition does not entail a risk for any unwary party unfamiliar with this type of arbitration since an express authorization by the parties is required.

9. No attempt is made in the Model Law to define this type of arbitration, which comes in various and often vague forms. It is submitted, however, that the parties may in their authorization provide some certainty, to the extent desired by them, either by referring to the kind of *amiable composition* developed in a particular legal system or by laying down the rules or guidelines and, for example, request a fair and equitable solution within the limits of the international public policy of their two States.

Relevance of terms of contract and trade usages

10. Article 28 does not expressly call upon the arbitral tribunal to decide in accordance with the terms of the contract and to take into account the trade usages applicable to the transaction. However, this does not mean that the Model Law would disregard or reduce the relevance of the contract and the trade usages.

11. This is clear from the various reasons advanced during the discussion of the Working Group against retaining such a provision.³² As regards the reference to the terms of the contract, it was stated, for example, that such reference did not belong in an article dealing with the law applicable to the substance of the dispute and was not needed in a law on arbitration, though appropriate in arbitration rules, or that such reference could be misleading where the terms of the contract were in conflict with mandatory provisions of law or did not express the true intent of the parties. As regards the reference to trade usages, the concerns related primarily to the fact that their legal effect and qualification were not uniform in all legal systems. For example, they may form part of the applicable law, in which case they were already covered by paragraph (1) or (2) of article 28. Finally, it was difficult to devise acceptable wording, in particular, to decide whether to adopt the formula of the UNCITRAL Arbitration Rules (art. 33 (3)) or of the 1980 Vienna Sales Convention (art. 9).

* * *

Article 29. Decision-making by panel of arbitrators

In arbitral proceedings with more than one arbitrator, any decision of the arbitral tribunal shall be made, unless otherwise agreed by the parties, by a majority of all its members. However, the parties or the arbitral tribunal may authorize a presiding arbitrator to decide questions of procedure.

References

- A/CN.9/216, paras. 76-77
- A/CN.9/232, paras. 136-140
- A/CN.9/245, paras. 101-104
- A/CN.9/246, paras. 105-108

Commentary

1. Article 29 deals with one important aspect of the decision-making process in those common cases where

³²A/CN.9/245, para. 99; A/CN.9/232, para. 164.

the arbitral tribunal consists of more than one arbitrator (in particular: three arbitrators). While leaving out other aspects relating to the mechanics of how a decision is arrived at, article 29 adopts the majority-principle for any award or other decision of the arbitral tribunal, with a possible exception for questions of procedure, which, for the sake of expediency and efficiency, the parties or the arbitral tribunal may authorize a presiding arbitrator to decide.

2. The majority-principle, as compared with requiring unanimity, is more conducive to reaching the necessary decisions and the final settlement of the dispute. This principle, which is also adopted for the signatures required on the award (article 31 (1)), does not mean, however, that not all arbitrators need take part in the deliberations or at least have the opportunity to do so.

3. Since article 29 is non-mandatory, the parties may lay down different requirements. For example, they may authorize a presiding arbitrator, if no majority can be reached, to cast the decisive vote, or to decide as if he were a sole arbitrator. The parties may also, for quantum decisions, provide a formula according to which the decisive amount would be calculated on the basis of the different votes of the arbitrators.

* * *

Article 30. *Settlement*

(1) If, during arbitral proceedings, the parties settle the dispute, the arbitral tribunal shall terminate the proceedings and, if requested by the parties and not objected to by the arbitral tribunal, record the settlement in the form of an arbitral award on agreed terms.

(2) An award on agreed terms shall be made in accordance with the provisions of article 31 and shall state that it is an award. Such an award has the same status and effect as any other award on the merits of the case.

References

- A/CN.9/216, paras. 95-97
- A/CN.9/232, paras. 171-176
- A/CN.9/245, paras. 105-107
- A/CN.9/246, paras. 109-110

Commentary

1. Article 30 deals with the fortunately not infrequent case that the parties themselves settle the dispute during, and often induced by, the arbitral proceedings. In order to make the settlement agreement enforceable, it is necessary, under nearly all legal systems, to record it in the form of an arbitral award.

2. The arbitral tribunal shall issue such an award on agreed terms, if requested by the parties and not objected to by it. The first condition is based on the

view that there are fewer dangers of injustice by requiring the request of both parties instead of only one, who, however, may have a particular interest, since a settlement may be ambiguous or subject to conditions which might not be apparent to the arbitral tribunal. The second condition is based on the view that the arbitral tribunal, although it would normally accede to such a request, should not be compelled to do so in all circumstances (e.g. in case of suspected fraud, illicit or utterly unfair settlement terms).

3. According to paragraph (2), an award on agreed terms shall be treated like any other award on the merits of the case, not only as regards its form and contents (article 31) but also its status and effect.

* * *

Article 31. *Form and contents of award*

(1) The award shall be made in writing and shall be signed by the arbitrator or arbitrators. In arbitral proceedings with more than one arbitrator, the signatures of the majority of all members of the arbitral tribunal shall suffice, provided that the reason for any omitted signature is stated.

(2) The award shall state the reasons upon which it is based, unless the parties have agreed that no reasons are to be given or the award is an award on agreed terms under article 30.

(3) The award shall state its date and the place of arbitration as determined in accordance with article 20 (1). The award shall be deemed to have been made at that place.

(4) After the award is made, a copy signed by the arbitrators in accordance with paragraph (1) of this article shall be delivered to each party.

References

- A/CN.9/216, paras. 78-80, 100-102, 105
- A/CN.9/232, paras. 141-145, 184-186
- A/CN.9/245, paras. 108-116
- A/CN.9/246, paras. 111-112

Commentary

Award in writing and signed, paragraph (1)

1. For the sake of certainty, the arbitral award shall be made in writing and signed by the arbitrator or arbitrators. However, corresponding with the provision on decision-making by a panel of arbitrators (article 29),⁴³ the signatures of the majority of all members of the arbitral tribunal shall suffice, provided that the reason for any omitted signature is stated.

⁴³The Commission may wish to consider the appropriateness of establishing full correspondence with article 29, by aligning the signature requirement to any agreed system other than decision by majority (see commentary to article 29, para. 3).

2. This proviso is certainly appropriate for those cases where, after the award has been finalized, an arbitrator dies or becomes physically unable to sign or cannot in fact be reached anymore. Where, however, an arbitrator refuses to sign, the proviso may be open to objection by those who are strictly against revealing whether an award was made unanimously or whether an arbitrator dissented. On the other hand, there are those who, based on their legal systems and practice, even want a provision in the Model Law entitling the dissenting arbitrator to state his opinion. The Commission might wish to consider whether the requirement of stating the reason for the omitted signature should be maintained in the proviso and whether the Model Law should take a stand on the separate issue of dissenting opinions, i.e. either generally allow or generally prohibit their issuance. At present, it is submitted, this question falls under article 19 (1) or (2) as a matter of the conduct of the proceedings.

Statement of reasons, paragraph (2)

3. The practice of stating the reasons upon which the award is based is more common in certain legal systems than in others and it varies from one type or system of arbitration to another. Paragraph (2) adopts a solution which accommodates such variety by requiring that the reasons be stated but allowing parties to waive that requirement. An agreement that no reasons are to be given would normally be made expressly, including reference to arbitration rules containing such waiver, but may also be implied, for example, in the submitting of a dispute to an established arbitration system which is known not to contemplate the giving of reasons. The same would apply to an intermediate solution, practised in certain systems, such as to state the reasons in a separate and confidential document.

Date and place of award, paragraph (3)

4. The date and the place at which the award is made are of considerable importance in various respects, in particular, as far as procedural consequences are concerned, in the context of recognition and enforcement and any possible recourse against the award. Paragraph (3), therefore, provides that the award shall state its date and the place of arbitration, which shall be deemed to be the place of the award.

5. This presumption, which should be regarded as irrebuttable,³⁴ is based on the principle that the award shall be made at the place of arbitration determined in accordance with article 20 (1). It also recognizes that the making of the award is a legal act which in practice is not necessarily one factual act but, for example, done in deliberations at various places, by telephone or correspondence.

Delivery of award, paragraph (4)

6. Paragraph (4) provides that a signed copy of the award be delivered to each party. Receipt of this copy is relevant, for example, as "receipt of the award" for the purposes of articles 33 (1), (3) and 34 (3) and as a

necessary condition for obtaining recognition or enforcement under article 35 (2). The Model Law does not require any other administrative act such as filing, registration or deposit of the award.

* * *

Article 32. Termination of proceedings

(1) The arbitral proceedings are terminated by the final award or by agreement of the parties or by an order of the arbitral tribunal in accordance with paragraph (2) of this article.

(2) The arbitral tribunal

(a) shall issue an order for the termination of the arbitral proceedings when the claimant withdraws his claim, unless the respondent objects thereto and the arbitral tribunal recognizes a legitimate interest on his part in obtaining a final settlement of the dispute;

(b) may issue an order of termination when the continuation of the proceedings for any other reason becomes unnecessary or inappropriate.

(3) The mandate of the arbitral tribunal terminates with the termination of the arbitral proceedings, subject to the provisions of articles 33 and 34 (4).

References

A/CN.9/232, paras. 132-135

A/CN.9/245, paras. 47-53, 117-119

A/CN.9/246, paras. 113-116

Commentary

1. Article 32, which deals with the termination of the arbitral proceedings, serves three purposes. The first one is to provide guidance in this last, but not unimportant, phase of the proceedings. A good example is paragraph (2) (a), which makes it clear that withdrawal of the claim does not *ipso facto* lead to termination of the proceedings.

2. The second purpose is to regulate the consequential termination of the mandate of the arbitral tribunal and its exceptions (paragraph (3)). A good example is that the arbitrators would become *functus officio* by making an award only if that is "the final award", i.e. the one which constitutes or completes the disposition of all claims submitted to arbitration. The third purpose is to provide certainty as to the point of time of the termination of the proceedings. This may be relevant for matters unrelated to the arbitration itself, for example, the continuation of the running of a limitation period or the possibility of instituting court proceedings.

* * *

Article 33. Correction and interpretation of awards and additional awards

(1) Within thirty days of receipt of the award, unless another period of time has been agreed upon by the

³⁴A/CN.9/245, para. 115.

parties, a party, with notice to the other party, may request the arbitral tribunal:

(a) to correct in the award any errors in computation, any clerical or typographical errors or any errors of similar nature;

(b) to give an interpretation of a specific point or part of the award.

The arbitral tribunal shall make the correction or give the interpretation within thirty days of receipt of the request. The interpretation shall form part of the award.

(2) The arbitral tribunal may correct any error of the type referred to in paragraph (1)(a) of this article on its own initiative within thirty days of the date of the award.

(3) Unless otherwise agreed by the parties, a party, with notice to the other party, may request, within thirty days of receipt of the award, the arbitral tribunal to make an additional award as to claims presented in the arbitral proceedings but omitted from the award. The arbitral tribunal shall make the additional award within sixty days, if it considers the request to be justified.

(4) The arbitral tribunal may extend, if necessary, the period of time within which it shall make a correction, interpretation or an additional award under paragraph (1) or (3) of this article.

(5) The provisions of article 31 shall apply to a correction or interpretation of the award or to an additional award.

References

- A/CN.9/216, para. 98
- A/CN.9/232, paras. 177-183
- A/CN.9/245, paras. 120-123
- A/CN.9/246, paras. 117-125

Commentary

1. Article 33 extends the mandate of the arbitral tribunal beyond the making of the award for certain measures of clarification and rectification, which may help to prevent continuing disputes or even setting aside proceedings. The first possible measure is to correct any error in computation or any clerical, typographical or similar error, either upon request by a party or on its own initiative. The second possible measure is to give an interpretation of a specific point or part of the award, as specified by a party, and to add this interpretation to the award. The third possible measure is to make an additional award as to any claim presented in the arbitral proceedings but omitted from the award (e.g. claimed interest was erroneously not awarded). If the arbitral tribunal considers the request, not necessarily the omitted claim, to be justified, it shall make an additional award, irrespective of whether any further hearing or taking of evidence is required for that purpose.

2. The period of time during which a party may request any such measure is thirty days of receipt of the award. The same period of time, calculated from the receipt of the request, is accorded to the arbitral tribunal for making the correction or giving the interpretation, while a time-limit of sixty days is set for the usually more difficult and time-consuming task of making an additional award. However, there are circumstances in which the arbitral tribunal would be unable, for good reasons, to comply with these time-limits. For example, the preparation of an interpretation may require consultations between the arbitrators, the making of an additional award may require hearings or taking of evidence, and in any case initially sufficient time must be given to the other party for replying to the request. The arbitral tribunal may, therefore, extend the time-limits, if necessary.

* * *

CHAPTER VII. RECOURSE AGAINST AWARD

Article 34. *Application for setting aside as exclusive recourse against arbitral award*

(1) Recourse to a court against an arbitral award made [in the territory of this State] [under this Law] may be made only by an application for setting aside in accordance with paragraphs (2) and (3) of this article.

(2) An arbitral award may be set aside by the Court specified in article 6 only if:

(a) the party making the application furnishes proof that:

- (i) the parties to the arbitration agreement referred to in article 7 were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of this State; or
- (ii) the party making the application was not given proper notice of the appointment of the arbitrator(s) or of the arbitral proceedings or was otherwise unable to present his case; or
- (iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or
- (iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Law from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Law; or

- (b) the Court finds that:
 - (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or
 - (ii) the award or any decision contained therein is in conflict with the public policy of this State.

(3) An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the award or, if a request had been made under article 33, from the date on which that request had been disposed of by the arbitral tribunal.

(4) The Court, when asked to set aside an award, may, where appropriate and so requested by a party, suspend the setting aside proceedings for a period of time determined by it in order to give the arbitral tribunal an opportunity to resume the arbitral proceedings or to take such other action as in the arbitral tribunal's opinion will eliminate the grounds for setting aside.

References

- A/CN.9/232, paras. 14-22
- A/CN.9/233, paras. 178-195
- A/CN.9/245, paras. 146-155
- A/CN.9/246, paras. 126-139

Commentary

Sole action for attacking award, paragraph (1)

1. Existing national laws provide a variety of actions or remedies available to a party for attacking the award. Often equating arbitral awards with local court decisions, they set varied and sometimes extremely long periods of time and set forth varied and sometimes long lists of grounds on which the award may be attacked. Article 34 is designed to ameliorate this situation by providing only one means of recourse (paragraph (1)), available during a fairly short period of time (paragraph (3)) and for a rather limited number of reasons (paragraph (2)). It does not, beyond that, regulate the procedure, neither the important question whether a decision by the Court of article 6 may be appealed before another court nor any question as to the conduct of the setting aside proceedings itself.

2. The application for setting aside constitutes the exclusive recourse to a court against the award in the sense that it is the only means for actively attacking the award, i.e. initiating proceedings for judicial review. A party retains, of course, the right to defend himself against the award by requesting refusal of recognition or enforcement in proceedings initiated by the other party (articles 35 and 36). Obviously, article 34 (1) does not exclude the right of a party to request any correction or interpretation of the award or the making of an additional award under article 33, since such request would be directed to the arbitral tribunal and not to a court; the situation is different in the case of a

remission to the arbitral tribunal under article 34 (4), which is envisaged as a possible response by a court to an application for setting aside the award. Finally, article 34 (1) would not exclude recourse to a second arbitral tribunal, where such appeal within the arbitration system is envisaged (as, e.g., in certain commodity trades).

3. Article 34 provides recourse against an "arbitral award" without specifying which kinds of decision would be subject to such recourse. The Working Group was agreed that it was desirable for the Model Law to define the term "award" and noted that such definition had important implications for a number of provisions of the Model Law, especially articles 34 and 16. After commencing consideration of a proposed definition, the Working Group decided, for lack of time, not to include a definition in the Model Law to be adopted by it and to invite the Commission to consider the matter.⁸⁵

4. Another matter to be considered by the Commission is the question of the territorial scope of application, the pending nature of which is clear from the alternative wordings placed between square brackets in paragraph (1). It is submitted that the territorial scope of article 34 should be the same as the one of the Model Law in general, whichever may be the criterion adopted by the Commission.⁸⁶

Reasons for setting aside the award, paragraph (2)

5. Paragraph (2) lists the various grounds on which an award may be set aside. This listing is exhaustive, as expressed by the word "only" and reinforced by the character of the Model Law as *lex specialis*.⁸⁷

6. Paragraph (2) sets forth essentially the same reasons as those on which recognition or enforcement may be refused under article 36 (1) (or article V of the 1958 New York Convention, on which it is closely modelled). It even uses, with few exceptions, the same wording, for the sake of harmony in the interpretation.

7. The list of reasons presented in paragraph (2) is based on two different policy considerations, which, however, converge in their result. First, after an extensive selection process, which included a considerable number of other grounds suggested for inclusion in the list, the reasons set forth in paragraph (2), and only these, were regarded as appropriate in the context of setting aside of awards in international commercial arbitration.

8. Second, conformity with article 36 (1) is regarded as desirable in view of the policy of the Model Law to reduce the impact of the place of arbitration. It recognizes the fact that both provisions with their different purposes (in one case reasons for setting aside and in the other case grounds for refusing recognition or enforcement) form part of the alternative defence system which provides a

⁸⁵A/CN.9/246, paras. 129, 192-194.

⁸⁶As to this general question of the territorial scope of application of the Model Law, see commentary to article 1, paras. 4-6.

⁸⁷See commentary to article 1, paras. 7-8.

party with the option of attacking the award or invoking the grounds when recognition or enforcement is sought. It also recognizes the fact that these provisions do not operate in isolation. The effect of traditional concepts and rules familiar and peculiar to the legal system ruling at the place of arbitration is not limited to the State where the arbitration takes place but extends to many other States by virtue of article 36 (1) (a) (v) (or article V (1) (e) of the 1958 New York Convention) in that an award which has been set aside for whatever reasons recognized by the competent court or applicable procedural law, would not be recognized and enforced abroad.

9. Drawing the consequences from this undesirable situation, article IX of the 1961 Geneva Convention cuts off this international effect in respect of all awards which have been set aside for reasons other than those listed in article V of the 1958 New York Convention. The Model Law merely takes this philosophy one step further by going beyond the angle of recognition and enforcement to the source and aligning the very reasons for setting aside with those for refusing recognition or enforcement. This step has the salutary effect of avoiding "split" or "relative" validity of international awards, i.e. awards which are void in the country of origin but valid and enforceable abroad.⁸⁸

10. Since the grounds listed in paragraph (2) are essentially those of article V of the 1958 New York Convention, they are familiar and require no detailed explanation; however, the fact that they are used for purposes of setting aside under the Model Law leads to some differences. For example, the application of subparagraphs (a) (i) and (iv), possibly also (iii), may be limited by virtue of an implied waiver or submission, as mentioned in the commentary to article 4 (para. 6) and to article 16 (paras. 8-9).

11. Subparagraph (a) (iv) expresses the priority of the mandatory provisions of the Model Law over any agreement of the parties, which is different from article 36 (1) (a) (iv), at least according to the predominant interpretation of the corresponding provision in the 1958 New York Convention (article V (1) (d)). The fact that the composition of the arbitral tribunal and the arbitral procedure are, thus, to be judged by the mandatory provisions of the Model Law entails, for example, that this subparagraph (a) (iv) covers to a large extent also the grounds of subparagraph (a) (ii), copied from the 1958 New York Convention, which comprise cases of violations of articles 19 (3) and 24 (3), (4).

12. Yet another difference is less obvious since it follows merely from the different effect of setting aside as compared to refusing recognition or enforcement. Under subparagraph (b) (i), an award would be set aside if the court finds that the subject-matter of the dispute is not capable of settlement by arbitration "under the law of this State". This reason is certainly appropriate for refusing recognition or enforcement in a given State, which often regards it as part of its public policy and

may reduce its impact by protecting only its *ordre public international*, i.e. its public policy concerning international cases. However, this same reason used for setting aside gains a different dimension by virtue of the global effect of setting aside (article 36 (1) (a) (v), or article V (1) (e) of the 1958 New York Convention). As was suggested in the Working Group, to quote now from the report of the seventh session (A/CN.9/246, paras. 136-137),

"... such global effect should obtain only from a finding that the subject-matter of the dispute was not capable of settlement by arbitration under the law applicable to that issue which was not necessarily the law of the State of the setting aside proceedings. It was, therefore, suggested to delete the provision of paragraph (2) (b) (i). The result of that deletion, which received considerable support, would be to limit the court control under article 34 to those cases where non-arbitrability of a certain subject-matter formed part of the public policy of that State (para. (2) (b) (ii)) or where the Court regarded arbitrability as an element of the validity of an arbitration agreement (para. (2) (a) (i)), although some proponents of that suggestion sought the more far-reaching result of excluding non-arbitrability as a reason for setting aside. Another suggestion was to delete, in paragraph (2) (b) (i), merely the reference to "the law of this State" and, thus, to leave open the question as to which was the law applicable to arbitrability. The Working Group, in discussing those suggestions, was agreed that the issues raised were of great practical importance and, in view of their complex nature, required further study. The Working Group, after deliberation, decided to retain, for the time being, the provision of paragraph (2) (b) (i) in its current form so as to invite the Commission to reconsider the matter and to decide, in the light of comments by Governments and organizations, on whether the present wording was appropriate or whether the provision should be modified or deleted."

"Remission" to arbitral tribunal, paragraph (4)

13. Paragraph (4) envisages a procedure which is similar to the "remission" known in most common law jurisdictions, though in various forms. Although the procedure is not known in all legal systems, it should prove useful in that it enables the arbitral tribunal to cure a certain defect and, thereby, save the award from being set aside by the Court.

14. Unlike in some common law jurisdictions, the procedure is not conceived as a separate remedy but placed in the framework of setting aside proceedings. The Court, where appropriate and so requested by a party, would invite the arbitral tribunal, whose continuing mandate is thereby confirmed, to take appropriate measures for eliminating a certain remediable defect which constitutes a ground for setting aside under paragraph (2). Only if such "remission" turns out to be futile at the end of the period of time determined by the Court, during which recognition and enforcement may be suspended under article 36 (2), would the Court

⁸⁸As to another effect, referred to as the potential risk of "double control" of domestic awards, see commentary to article 36, para. 3.

resume the setting aside proceedings and set aside the award.

* * *

CHAPTER VIII. RECOGNITION AND ENFORCEMENT OF AWARDS

Article 35. *Recognition and enforcement*

(1) An arbitral award, irrespective of the country in which it was made, shall be recognized as binding and, upon application in writing to the competent court, shall be enforced subject to the provisions of this article and of article 36.

(2) The party relying on an award or applying for its enforcement shall supply the duly authenticated original award or a duly certified copy thereof, and the original arbitration agreement referred to in article 7 or a duly certified copy thereof. If the award or agreement is not made in an official language of this State, the party shall supply a duly certified translation thereof into such language.*

(3) Filing, registration or deposit of an award with a court of the country where the award was made is not a pre-condition for its recognition or enforcement in this State.

References

- A/CN.9/216, paras. 103-104, 109
- A/CN.9/232, paras. 19-21, 187-189
- A/CN.9/233, paras. 121-175
- A/CN.9/246, paras. 140-148

Commentary

Appropriateness of including provisions on recognition and enforcement of awards irrespective of their place of origin

1. The chapter on recognition and enforcement of awards presents the result of extensive deliberations on basic questions of policy, in particular, whether the Model Law should contain provisions on recognition and enforcement of domestic and foreign awards, and, if so, whether these two categories of awards should be treated in a uniform manner, and how closely any provisions on recognition and enforcement should follow the corresponding articles of the 1958 New York Convention. As evidenced by article 35 and its companion article 36, the prevailing answer to these basic policy questions was that the Model Law should contain uniform provisions on recognition and enforcement of all awards, irrespective of the place of origin, and in full harmony with the 1958 New York Convention.

*The conditions set forth in this paragraph are intended to set maximum standards. It would, thus, not be contrary to the harmonization to be achieved by the Model Law if a State retained even less onerous conditions.

2. The main reasons are, in short, the following: While foreign awards are appropriately dealt with in the 1958 New York Convention, which is widely adhered to, often with the restriction of reciprocity, and is open to any State prepared to accept its liberal provisions, the Model Law would be incomplete if it would not offer an equally liberal set of rules, in full harmony with the 1958 New York Convention, including its safeguards in article V, and without adversely affecting its effect and application, in order to establish a supplementary network of recognition and enforcement of awards not covered by any multilateral or bilateral treaty. While domestic awards are often treated by national laws under the same favourable conditions as local court decisions, the disparity of national laws is not conducive to facilitating international commercial arbitration and the Model Law should, therefore, aim at unifying the domestic treatment in all legal systems, without imposing restrictive conditions.

3. Above all, these provisions on recognition and enforcement would go a long way towards securing the uniform treatment of all awards in international commercial arbitration irrespective of where they happen to be made. To draw the line between such "international" awards and "non-international", i.e. truly domestic, awards (instead of distinguishing on territorial grounds between foreign and domestic awards), would further the policy of reducing the relevance of the place of arbitration and thereby widen the choice and enhance the vitality of international commercial arbitration. This idea of uniform treatment of all international awards was the major decisive reason which any State may wish to consider when assessing the acceptability of this chapter of the Model Law.

Recognition of award and application for its enforcement, paragraph (1)

4. Article 35 draws a useful distinction between recognition and enforcement in that it takes into account that recognition not only constitutes a necessary condition for enforcement but also may be standing alone, e.g. where an award is relied on in other proceedings. Under paragraph (1), an award shall be recognized as binding, which means, although this is not expressly stated, binding between the parties and from the date of the award.⁸⁹ An award shall be enforced upon application in writing to the "competent court".⁹⁰ Both recognition and enforcement are subject to the provisions of article 36 and the conditions laid down in paragraph (2) of article 35.

Conditions of recognition and enforcement, paragraph (2)

5. Paragraph (2), which is modelled on article IV of the 1958 New York Convention, does not lay down the

⁸⁹A/CN.9/246, para. 148. As a practical matter, the award may in fact be relied on by a party only from the date of receipt.

⁹⁰The reference is to the competent court, and not to the Court specified in article 6, because the Model Law does not aim at unifying national laws on the organization of the judicial system and, in particular, because the competence of courts for enforcement is normally linked to the residence of the debtor or location of property or assets.

procedure but merely the conditions for recognition and enforcement. The party relying on an award or applying for its enforcement shall supply, in an official language of the State, that award and its constituent document, i.e. the arbitration agreement.⁹¹ According to the footnote accompanying the text, these conditions are intended to set maximum standards; thus a State may retain even less onerous conditions.

No filing, registration or deposit required, paragraph (3)

6. The Model Law, which itself does not require filing, registration or deposit of awards made under its régime (article 31), also does not require such actions in respect of foreign awards whose recognition or enforcement is sought under its régime, following the policy of the 1958 New York Convention of doing away with the "double exequatur".

* * *

Article 36. Grounds for refusing recognition or enforcement

(1) Recognition or enforcement of an arbitral award, irrespective of the country in which it was made, may be refused only:

(a) at the request of the party against whom it is invoked, if that party furnishes to the competent court where recognition or enforcement is sought proof that:

- (i) the parties to the arbitration agreement referred to in article 7 were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or
- (ii) the party against whom the award is invoked was not given proper notice of the appointment of the arbitrator(s) or of the arbitral proceedings or was otherwise unable to present his case; or
- (iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or
- (iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or, failing such agreement, was not in accordance with

the law of the country where the arbitration took place; or

- (v) the award has not yet become binding on the parties or has been set aside or suspended by a court of the country in which, or under the law of which, that award was made; or
- (b) if the court finds that:
 - (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or
 - (ii) the recognition or enforcement of the award would be contrary to the public policy of this State.

(2) If an application for setting aside or suspension of an award has been made to a court referred to in paragraph (1) (a) (v) of this article, the court where recognition or enforcement is sought may, if it considers it proper, adjourn its decision and may also, on the application of the party claiming recognition or enforcement of the award, order the other party to provide appropriate security.

References

- A/CN.9/216, para. 109
- A/CN.9/232, paras. 19-20
- A/CN.9/233, paras. 133-177
- A/CN.9/245, paras. 137-145
- A/CN.9/246, paras. 149-155

Commentary

Grounds for refusing recognition or enforcement of "international" awards, paragraph (1)

1. Based on the prevailing policy considerations stated above,⁹² article 36 (1) adopts almost literally the well-known grounds set forth in article V of the 1958 New York Convention and declares them as applicable to refusal of recognition or enforcement of all awards, irrespective of where they were made. Thus, the provision, like article 35, covers foreign as well as domestic awards, provided they are rendered in "international commercial arbitration" as referred to in article 1 and, of course, subject to any multilateral or bilateral treaty to which the enforcement State is a party.

2. As regards foreign awards, full harmony with article V is obviously desirable. The reasons taken from there were even viewed as providing sufficient safeguards to the enforcement State which would make it unnecessary to restrict recognition and enforcement by requiring reciprocity. It was also thought that a model law on international commercial arbitration should not promote the use of such territorial restrictions and that, from a technical point of view, it was difficult, although not impossible, to devise a workable mechanism in a "unilateral" text such as the Model Law. Nevertheless, the Model Law does not preclude a State from adopting

⁹¹As regards this second condition, it is submitted that an exception be made for those cases where an original defect in form was cured by waiver or submission, for example, where arbitral proceedings were on the basis of an oral agreement initiated and not objected to by any party. In such case the supply of an award, which records the waiver or submission, should suffice.

⁹²Commentary to article 35, paras. 1-3.

a mechanism of reciprocity, in which case the basis or connecting factor and the technique used should be specified in the national enactment.

3. The list of reasons seems also appropriate for domestic awards, although its correspondence with the grounds for setting aside entails the potential of what has been referred to as undesirable "double control", i.e. two occasions for judicial review of the same grounds. This should be an acceptable consequence of the uniform treatment of all awards, based on the policy of reducing the relevance of the place of arbitration. In view of the different purposes and effects of setting aside and of invoking grounds for refusal of recognition or enforcement, a party should be free to avail himself of the alternative system of defences (as such recognized by the 1958 New York Convention) also in those cases where recognition or enforcement happens to be sought in the State where the arbitration took place. As regards the potential risk of double procedures on the same grounds, it is submitted that these concerns are essentially met by paragraph (2) (see below, para. 5).

4. The fact that the grounds listed in paragraph (1) are applicable to foreign as well as domestic awards, must be taken into account when interpreting the text, which is in large measure copied from an article applicable

only to foreign awards (article V of the 1958 New York Convention). For example, the references to "the law of the country where the award was made" (subparagraph (a) (i)) or "the law of the country where the arbitration took place" (subparagraph (a) (iv)) or to "a court of the country in which, or under the law of which, that award was made" (subparagraph (a) (v)) may either lead to a foreign law, which may or may not have been modelled on the Model Law, or to the Model Law of "this State". In the latter case, i.e. a domestic setting, account should be taken of the kind of considerations mentioned in respect of the grounds for setting aside, for example, the limiting effect of an implied waiver or submission (articles 4 and 16 (2)) upon the reasons set forth in paragraph (1) (a) (i) and (iv).⁹³

Suspension of recognition or enforcement, paragraph (2)

5. Paragraph (2) is modelled on article VI of the 1958 New York Convention. In line with the wider scope of the Model Law, it covers not only foreign but also domestic awards rendered in international commercial arbitration. Thus, it can be used to avoid concurrent judicial review of the same grounds and possibly conflicting decisions, where this risk is not already excluded by the fact that the same court is seized with the application for setting aside and the other party's application for enforcement.

⁹³Commentary to article 34, paras. 10-11.

II. INTERNATIONAL PAYMENTS

A. International negotiable instruments

Report of the Working Group on International Negotiable Instruments on the work of its thirteenth session
(New York, 7-18 January 1985) (A/CN.9/261)^a

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Introduction

1. The United Nations Commission on International Trade Law, at its seventeenth session (New York, 25 June-10 July 1984), considered the draft Convention on International Bills of Exchange and International Promissory Notes as prepared by the Working Group

and contained in document A/CN.9/211. As regards its future course of action, the Commission decided that further work should be undertaken with a view to improving the draft Convention and entrusted this work to the Working Group on International Negotiable Instruments.¹

¹Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 88.

^aFor consideration by the Commission, see *Report*, chapter III, A (part one, A, above).

2. The mandate of the Working Group was to revise the draft Convention on International Bills of Exchange and International Promissory Notes in the light of decisions and discussion at the seventeenth session of the Commission,² and also taking into account those comments of Governments and international organizations in documents A/CN.9/248 and A/CN.9/249/Add.1 which were not discussed at that session.

3. The Working Group held its thirteenth session at United Nations Headquarters in New York from 7 to 18 January 1985. The Working Group consists, according to the decision of the Commission at its seventeenth session,³ of the following 14 members of the Commission: Australia, Cuba, Czechoslovakia, Egypt, France, India, Japan, Mexico, Nigeria, Sierra Leone, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland and United States of America. With the exception of Sierra Leone, all members of the Working Group were represented at the thirteenth session. The session was also attended by observers of the following States: Argentina, Austria, Canada, Chile, China, Côte d'Ivoire, Democratic Yemen, Ecuador, El Salvador, Germany, Federal Republic of Greece, Hungary, Iran (Islamic Republic of), Iraq, Italy, Netherlands, Norway, Oman, Paraguay, Portugal, Qatar, Republic of Korea, Romania, Sweden, Switzerland, Syrian Arab Republic, Thailand, Turkey and Yugoslavia, as well as by observers from the following international organizations: Hague Conference on Private International Law, International Bar Association and International Chamber of Commerce.

4. The Working Group elected the following officers:

Chairman: Willem Vis (Netherlands)*

Rapporteur: G. O. Adebajo (Nigeria)

5. The Working Group had before it the following documents:

Provisional agenda (A/CN.9/WG.IV/WP.28).

Draft Convention on International Bills of Exchange and International Promissory Notes: text of draft articles as adopted by the Working Group on International Negotiable Instruments: note by the secretariat (A/CN.9/WG.IV/WP.28).

Commentary on draft Convention on International Bills of Exchange and International Promissory Notes: report of the Secretary-General (A/CN.9/213).

Draft Convention on International Bills of Exchange and International Promissory Notes and draft Convention on International Cheques: analytical compilation of comments by Governments and international organizations (A/CN.9/248).

Draft Convention on International Bills of Exchange and International Promissory Notes and draft Convention on International Cheques: major controversial and other issues (A/CN.9/249).

Draft Convention on International Bills of Exchange and International Promissory Notes and draft Convention on International Cheques: major controversial and other issues—addendum: summary of the comments of Romania and Switzerland (A/CN.9/249/Add.1).

Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17).

Deliberations and decisions

6. The Working Group took note of the mandate conferred upon it by the Commission, namely to revise the draft Convention on International Bills of Exchange and International Promissory Notes in the light of the decisions taken and the discussion held at the seventeenth session of the Commission and also taking into account those comments of Governments and international organizations contained in documents A/CN.9/248 and A/CN.9/249/Add.1, which were not discussed at that session.

7. The Working Group commenced its review of the draft Convention on International Bills of Exchange and International Promissory Notes by considering the major controversial issues, as set forth in document A/CN.9/249 and as discussed by the Commission at its seventeenth session,⁴ and some related questions.

8. The Working Group decided, subject to approval by the Commission, to hold its next session (the fourteenth session) at Vienna from 9 to 20 December 1985.

Draft Convention on International Bills of Exchange and International Promissory Notes: consideration of major controversial issues and some related questions

I. The concept of holder and protected holder

A. Definition of protected holder

9. The Working Group considered whether a person who had taken an incomplete instrument and had completed it in accordance with the agreement between the payee and the drawer or the maker could qualify as a protected holder. The Working Group, after deliberation, was of the view that the mere fact that the instrument was incomplete should not prevent a person from becoming a protected holder provided he complied with the provisions of article 11.

*The Chairman was elected in his personal capacity.

²The discussion and conclusions on major controversial and other issues are set forth in the report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), paras. 21-82.

³*Ibid.*, para. 88.

⁴*Ibid.*, paras. 21-38.

10. Various suggestions were made to effect that result. Under one proposal, the words in article 4 (7) "when he became a holder, was complete and regular on its face" would be deleted. Under another proposal, the word "complete" would be retained but would be qualified by the following addition "or was incomplete but which could be completed in accordance with article 11 (1) and was completed in accordance with an agreement entered into".

11. It was agreed that the point of time at which it should be determined whether a person had protected holder status was not the time when the person took the incomplete instrument but when he completed it.

12. Opinions were divided on the question whether a holder who took an instrument that was irregular on its face could qualify as a protected holder. Under one view, the requirement that the instrument be regular on its face should be retained in view of the fact that an instrument showing apparent defects should put the holder on notice that a claim to or a defence upon the instrument might exist. Under another view, the criterion that the instrument be regular on its face should be deleted because: (a) it was difficult to determine exactly what was meant by regular or irregular, and (b) the concerns of those who favoured denying protected holder status to a holder taking an instrument that was irregular on its face were met by the rule that knowledge of a particular irregularity would amount to knowledge of a particular claim or defence. The reference to regularity was thus not indispensable.

13. The Working Group considered the following revised version of article 4 (7), prepared by the secretariat:

"(7) 'Protected holder' means the holder of an instrument which, when he obtained it, was [regular on its face and] complete or, if incomplete as referred to in article 11 (1), was completed by him in accordance with an agreement entered into, provided that, when he became a holder:

"(a) He was without knowledge of a claim to or defence upon the instrument referred to in article 25 or of the fact that it was dishonoured by non-acceptance or non-payment; and

"(b) The time-limit provided by article 51 for presentment of that instrument for payment had not expired."

14. The Working Group adopted this text of article 4 (7), subject to the deletion of the words between square brackets "regular on its face and". The Working Group was of the view that these words could be deleted since it was clear from other provisions in the draft Convention, particularly article 5 on the definition of knowledge, that the holder who took an instrument on which there was, for instance, visible evidence of forgery or material alteration could not qualify as a protected holder. With respect to subparagraph (a) of article 4 (7), see the discussion and decision of the Working Group in the context of article 26 (below, para. 26).

B. *Defences and claims that may be set up against a holder (article 25)*

15. The Working Group discussed whether the fact that a holder took an instrument with knowledge of a particular claim or defence should make him vulnerable to other claims or defences of which he had no knowledge. The following examples were given:

(a) The payee C of an instrument obtains it from the drawer A by fraud; in turn, D obtains the instrument from C by fraud; D has no knowledge of the fraud perpetrated by C on A. There was general agreement that, under the draft Convention, D should not be a protected holder and he should be subject to the claim by A to the instrument or to the defence by A on the instrument based on fraud;

(b) If A had a defence against C not based on fraud of which D, who defrauded C, had no knowledge, D should not be a protected holder and would be subject to the defence of A;

(c) If D transferred the instrument to E, who knew of the fraud committed by D, E would be subject to the defence of fraud set up by A in an action by E against him;

(d) If A had a defence against C based on the delivery of defective goods and D obtained the instrument from C by fraud, E, to whom D transferred the instrument, would be subject to the defence of A if E had knowledge of the fraud committed by D against C.

16. The Working Group, after deliberation, concluded that the draft Convention should not give protected holder status to a holder who took the instrument by fraud or by theft or who knew that fraud or theft had been committed by a prior party. On the other hand, the mere fact that the holder had knowledge of a defence not based on fraud or theft should not necessarily deprive him of protection against defences of which he had no knowledge. Thus, the holder who had knowledge of defence X of the drawer against the payee should cut off defence Y of the drawer against the payee if he had no knowledge of that defence. It was suggested that that result could be achieved by modifying article 25 concerning the rights of a holder.

17. The Working Group set up an *ad hoc* working party composed of the representatives of Austria, Canada, the Union of Soviet Socialist Republics and the United States of America and requested it to prepare a draft proposal.

18. The *ad hoc* working party proposed to add to article 25 a new paragraph (4):

"A holder is subject to a defence under paragraph (1) (b) or to a claim under paragraph (2) of this article only if he took the instrument with knowledge of such defence or claim or if he obtained it by fraud or participated at any time in a fraud concerning it."

19. The Working Group adopted the draft provision, subject to the following modifications. After the words "A holder" should be inserted the words "who is not a

protected holder", and the words "concerning it" shall be replaced by the words "affecting it". The new paragraph is to follow paragraph (2) of article 25 and, for the time being, to be labelled as paragraph (2 bis).

C. Defences and claims that may be set up against a protected holder (article 26)

20. It was noted that article 26 (1) (c) referred to two defences, namely that based on incapacity and that based on fraud in the *factum*. The Working Group discussed the question whether other defences such as duress, misrepresentation or impossibility should be added as defences available against a protected holder. The prevailing view was that only the two defences referred to in subparagraph (c) should be available.

21. The Working Group considered the proposal that the words in paragraph (2) "or arising from any fraudulent act on the part of such holder in obtaining the signature on the instrument of that person" be deleted. It was stated that this particular provision could apply in the case where a protected holder obtained fraudulently an acceptance from the drawee or a signature from a guarantor. The Working Group noted that the preparatory work on the draft Convention, as reflected in the reports of the Working Group, did not set forth any specific reason why the above wording had been added to an earlier version of paragraph (2). It was thought likely that the wording had been added in order to align paragraph (2), which was concerned with a claim to the instrument, with the provision of paragraph (1) (b), which contained similar wording in respect of defences.

22. While some representatives expressed doubts as to the usefulness of such wording in paragraph (2), the Working Group decided to retain the present text of article 26 (2).

23. With particular regard to article 26 (1) (b), the proposal was made that the protected holder, in addition to the defences listed in article 26 (1) should also be subject to defences to contractual liability based on a transaction, not related to the issue or the transfer of the instrument, between himself and the party from whom he claimed payment. Therefore, as between a protected holder and the party he had dealt with, even those defences that did not derive from the underlying transaction which gave rise to the issue or the transfer of the instrument, could be set up. The following example was given: the maker A issues a note to the payee B; B transfers the note to C; because of a previous transaction between B and C, unrelated to the transfer of the note, C is indebted to B; upon dishonour by non-payment, C demands payment from B. B should be able to raise, as a defence to his liability on the note, the fact that C is indebted to him, in spite of the fact that C is a protected holder.

24. The proposal was opposed on the ground that defences to liability on the instrument should be derived only from the transaction which gave rise to the issue or

the transfer of the instrument to a protected holder. The indebtedness of C could be the subject of a set-off or counter-claim off the instrument which, under some legal systems, was governed by general rules, in particular those on civil procedure, which in turn reflected different attitudes in this respect. Another ground on which the proposal was opposed was that it diminished the rights of a protected holder and that this was undesirable.

25. A more limited proposal was to enlarge the present wording of article 26 (1) (b) so as to cover not only defences derived from the underlying transaction itself but, at least, also defences deriving from agreements which were related to such transaction. Special reference was made to agreements for prolongation.

26. In the context of these proposals, it was noted that the definition of protected holder as set forth in article 4 (7) required, in its subparagraph (a), that the holder be without knowledge of a defence upon the instrument referred to in article 25, which, in its paragraph (1) (c), included any defence to contractual liability based on a transaction between the holder and an immediate party. The Working Group requested the secretariat to reconsider the definition of protected holder in article 4 (7), in particular the appropriateness of the reference in subparagraph (a) to all defences listed in article 25. The secretariat should further consider which defences should be available to an immediate party of a holder or a protected holder (under articles 25 and 26), with particular regard to the provisions of article 25 (1) (c) and article 26 (1) (b). The text to be submitted by the secretariat should be accompanied by explanatory notes in which the various possible solutions should be tested at the hand of concrete examples.

27. The Working Group decided to postpone to its next session consideration of the following suggestion which had been made during the discussion at the Commission's seventeenth session: it ought to be considered whether the draft Convention should protect a holder only in those cases in which he took the instrument in good faith, and whether the shelter rule (article 27) should enable a holder to have the rights of a protected holder even though he had taken the instrument in bad faith.³

II. Forged endorsements and endorsements by agent without authority (article 23)

A. Basic policy issues concerning forged endorsements

28. The Working Group noted that article 23 (1) was the result of a compromise between common law and civil law systems in that it followed the Geneva approach under which a forged endorsement would not prevent the endorsee and a subsequent transferee from being a holder and, at the same time, reached the result obtaining in common law jurisdictions which placed the

³*Ibid.*, para. 32.

risk of loss consequent upon the forged endorsement ultimately on the person who took the instrument from the forger.

29. It was also noted that, according to paragraph (2), the liability of a party or the drawee who paid, or of an endorsee for collection who collected, an instrument on which an endorsement was forged was not regulated by the Convention and was thus left to the applicable national law. Doubts were expressed whether it was acceptable to leave important matters regarding negotiable instruments to national laws, which differed considerably.

B. Liability of endorsee for collection

30. Under one view, article 23 should state that the endorsee for collection was not liable for any damages which a party or the person whose endorsement was forged would suffer because of the forgery. In support of this view, it was stated that the endorsee for collection was usually a bank which provided a service to its customers and was not in the best position to conduct extensive investigations as to whether the endorser had title to the instrument or authority to sign it.

31. On the other hand, it was pointed out that some legal systems placed the ultimate liability in the collection process upon the person or bank which took the instrument from the forger. If this liability were taken away, the person whose endorsement was forged would be left without the remedies which he would have under national law. This was a particularly serious matter in that, since under article 23 a forged endorsement was a good endorsement for purposes of transfer and would result in the transferee being a holder, payment of the instrument would, under the draft Convention, be payment to a holder and would thus lead to a discharge of liabilities on the instrument. In such a case, the person from whom the instrument was stolen and whose endorsement was forged would not have a cause of action for conversion which he would have, at least under some systems, against the drawee who paid.

32. The Working Group, after deliberation, accepted a compromise solution under which the endorsee for collection who took the instrument from the forger under a forged collection endorsement should not be liable under article 23 (1) if he was without knowledge of the forgery, provided that such absence of knowledge was not due to his negligence.

33. Divergent views were expressed as to the relevant time at which knowledge of the forgery would trigger liability. The Working Group considered in this respect the time at which the endorsee for collection received the instrument from the forger, the time at which he collected the amount of the instrument from the drawee or a party, and the time at which he transferred the funds he collected to the forger. The Working Group was agreed that the endorsee for collection should be liable if, up to the time at which he accounted to his

principal, he acquired knowledge of the forgery. However, he should also be liable in the case where he credited the account of his principal before collecting the instrument and learned about the forgery after crediting his principal's account.

C. Liability of a party or the drawee paying the instrument

34. It was noted that the drawee who had not accepted the bill of exchange was not liable on the instrument and that the question whether payment by the drawee was proper payment and whether the drawee who paid could debit the account of the drawer, and in what circumstances, could depend on the contractual arrangements between the drawer and the drawee. It was suggested that, since the liability of the drawee for payment and non-payment was a liability off the instrument, the draft Convention should not deal with these issues.

35. Under another view, however, payment by the drawee of an instrument on which an endorsement was forged could affect the rights of the person whose endorsement was forged. Consequently this issue should be addressed by the draft Convention. In this connection, reference was made to article 73 (2), according to which payment by the drawee resulted in the discharge of all parties of their liabilities on the instrument.

36. The Working Group, upon analysis of the various issues involved, decided to adopt the same régime as the one it had agreed upon in respect of the endorsee for collection (see above, para. 32) also for the acceptor, the maker and the drawee who paid the instrument directly to the forger of an endorsement. Thus, if such payment resulted in damages suffered by a certain party or the person whose endorsement was forged, the payor was not liable if payment was made to the forger without knowledge of the forgery, provided that such absence of knowledge was not due to his negligence.

D. Persons entitled to compensation

37. The Working Group noted that, under article 23 (1), "any party" had the "right to recover compensation for any damages that he may have suffered because of the forgery". It was agreed that this right should, on the one hand, also be accorded to "the person whose endorsement was forged". On the other hand, not every party to the instrument who suffered damage because of the forgery should be given the right for compensation under article 23 (1) but only those parties who signed the instrument before the forgery. Such limitation was justified because the rationale underlying article 23 was that a remedy should be given in first instance to the person whose endorsement was forged and in second instance to the party who was dispossessed of the instrument. For example, if an instrument was stolen from the post before it reached the payee, the drawer or the maker should be entitled to

compensation under article 23 (1). On the other hand, a party who signed the instrument after the forgery was protected sufficiently by his right of recourse against a prior party or, in the absence of an endorser's liability, by his right of action under article 41.

E. Conclusions and decisions on forged endorsements (article 23 (1) and (2))

38. The Working Group considered the following draft proposal prepared by an *ad hoc* working party composed of the representatives of France and the United Kingdom and the observers of Canada and Switzerland:

"(1) If an endorsement is forged, the person whose endorsement is forged or any party who signed the instrument before the forgery has the right to recover compensation for any damage that he may have suffered because of the forgery against:

"(a) the forger,

"(b) the person to whom the instrument was directly transferred by the forger,

"(c) a party or the drawee who paid the instrument directly to the forger.

"(2) However, an endorsee for collection shall not be liable under paragraph (1) if, at the later of:

"(a) the time he receives the proceeds of the instrument and

"(b) the time at which he accounts to his principal for them,

he was without knowledge of the forgery, provided that such absence of knowledge was not due to his negligence.

"(3) Also, a party or the drawee who pays an instrument shall not be liable under paragraph (1) if, at the time he paid the instrument, he was without knowledge of the forgery, provided that such absence of knowledge was not due to his negligence.

"(4) Except as against the forger, the damages recoverable under paragraph (1) may not exceed the amount of the instrument, plus interest calculated at the rate of . . ."

39. The Working Group, after deliberation, adopted the draft proposal, subject to the following modification in paragraph (4). The Working Group was agreed that the amount recoverable under paragraph (1) from a person other than the forger should not exceed the amount referred to in article 66 or 67. One representative stated his reservation to this rule, with particular regard to the rate of interest provided for in article 66 (2). Some representatives and observers expressed the view that the reference to article 66 or 67 may be questionable in view of the fact that these articles also covered matters which were not relevant in the context of article 23. The Working Group requested the Secretariat to consider whether a more appropriate wording than the mere reference to these articles could be found.

40. It was noted that the above régime would generally impose strict liability on the person who dealt directly with the forger, unless he was an endorsee for collection or a party or the drawee who paid the instrument. One representative, in stating his reservation, and one observer expressed the view that holding such a person, who received the instrument from the forger in good faith, liable for damages was unacceptable and would thwart the circulation of the international instrument.

F. Endorsement by agent without authority (article 23 (3))

41. It was noted that article 23 (3) equated an endorsement, which was placed on an instrument by a person in a representative capacity without authority, with a forged endorsement. Divergent views were expressed as to whether such equation was justified.

42. Under one view, the equation was not justified since the bulk of the cases covered by article 23 (3) were of a different nature. While it was true that it should make no difference whether, for example, a thief forged the signature of the payee or whether he signed his own name but falsely presented himself as agent of the payee, most cases of endorsements by an agent without authority should be distinguished from cases of forgery for the following reasons. An agent without authority was not necessarily a stranger to the person who received the instrument from him and may even be a person who previously had full authority or was merely exceeding a still existing authority. In such cases there was less reason for the person receiving the instrument to be on guard and it was inappropriate to require from him extensive investigations into the details of the organizational set-up or other circumstances relating to the possible authority. It was pointed out that this was particularly true in cases of endorsements for collection in view of the fact that the collecting bank was merely providing a service to its customer. Some proponents of this view pointed out that it was equally unjustified to hold a person liable for taking an instrument which the agent without authority had endorsed, not for collection, if the endorsee had no knowledge of the lack of authority.

43. The prevailing view was that it was justified to treat the case of an endorsement by an agent without authority on the same footing as a forged endorsement. In support of this view, it was pointed out that the policy considerations which had been accepted in regard of article 23 (1) and (2) applied with equal force to paragraph (3). It was therefore justified to place the risk ultimately on the person who dealt directly with the unauthorized agent. It was further pointed out that it was well-nigh impossible to draw a precise line between forged endorsements and endorsements by an agent without authority in all cases. Moreover, it was noted that the provision would only apply in those cases where the agent did indeed not have the power to bind his principal. Thus it would not apply where, for example, the agent had apparent or implied authority under the applicable national law.

44. The Working Group requested an *ad hoc* working party composed of the representatives of Czechoslovakia, Mexico and Nigeria and the observers of Norway and Qatar to prepare a draft provision, if deemed appropriate by it as a separate article, which would deal exclusively with endorsements by an agent without authority and possibly contain features not contained in the rules governing forged endorsements.

45. The proposal of that working party was to replace article 23 (3) by the following new article 23 *bis*:

"(1) If an instrument is endorsed by a person as an agent but without authority, any party or the person whom the unauthorized agent purports to represent has the right to recover compensation for any damage that he may have suffered because of such endorsement against:

"(a) the unauthorized agent, and

"(b) the person to whom the instrument was directly transferred by the unauthorized agent, or

"(c) a party or the drawee who paid the instrument directly to the unauthorized agent,

provided, however, that the person against whom compensation is sought shall not be liable unless, at the time when the instrument was transferred or paid, he had [or ought to have had] knowledge of the lack of authority.

"(2) Except as against the unauthorized agent, the damages recoverable under paragraph (1) may not exceed the amount referred to in article 66 or 67."

46. The Working Group, after consideration of this draft proposal, concluded that the final decision on the crucial issue of whether endorsements by an agent without authority should be equated with forged endorsements was possible only after the rules on forged endorsements had been agreed upon. Therefore, it requested the *ad hoc* working party which was entrusted with revising the rules on forged endorsements (see above, para. 38) to prepare a revised draft of article 23 *bis*.

47. The revised draft prepared by this *ad hoc* working party, composed of the representatives of France and the United Kingdom and the observers of Canada and Switzerland, was as follows:

"(1) If an endorsement is made by an agent without authority or power to bind his principal in the matter, the principal or any party who signed the instrument before such endorsement has the right to recover compensation for any damage that he may have suffered because of such endorsement against:

"(a) the agent,

"(b) the person to whom the instrument was directly transferred by the agent,

"(c) a party or the drawee who paid the instrument directly to the agent.

"(2) However, an endorsee for collection shall not be liable under paragraph (1) if, at the later of:

"(a) the time he receives the proceeds of the instrument and,

"(b) the time at which he accounts to his principal for them,

he was without knowledge that the endorsement did not bind the principal, provided that such absence of knowledge was not due to his negligence.

"(3) Also, a party or the drawee who pays an instrument shall not be liable under paragraph (1) if, at the time he paid the instrument, he was without knowledge that the endorsement did not bind the principal, provided that such absence of knowledge was not due to his negligence.

"(4) Except as against the agent, the damages recoverable under paragraph (1) may not exceed the amount of the instrument, plus interest calculated at the rate of . . ."

48. The Working Group, after deliberation, adopted this revised draft text, subject to improvement of its drafting and to the alignment of its paragraph (4) with the corresponding provision relating to forged endorsements (see above, para. 39). One representative maintained the view that the equation of endorsements by an agent without authority with forged endorsements was not justified and stated his reservation with regard to paragraph (1) (b).

III. Liability of a transferor by mere delivery (article 41)

49. The Working Group considered article 41 in the context of the following issues: (a) whether the draft Convention should recognize a liability on the part of persons who transferred the instrument by mere delivery, i.e. without endorsing it; (b) if so, what should be the nature and the extent of such liability, and in what circumstances could the liability be relied upon by a holder who received the instrument by mere delivery; and (c) should the liability for certain infirmities attaching to the instrument be imposed also upon endorsers.

A. Retention of provision on liability of transferor by mere delivery

50. It was noted that the negotiable instruments law of common law countries recognized that, in certain instances, a person who transferred an instrument by mere delivery warranted that the instrument was free from certain defects. It was also noted that under civil law systems the liability of the transferor by mere delivery in such cases was dealt with under the general law of contracts or under the law of sale of goods.

51. In view of the fact that, if the Convention were silent on this issue, the national laws, which differed in their approach, would govern, there was general agreement that the Convention should set forth rules regulating such liability. The substantive reason for

giving the holder who obtained an instrument by mere delivery a right of action against his transferor was that, in the absence of such an action, the holder could be without a remedy in cases when the instrument he took was not the instrument he legitimately expected to have received.

B. *Nature and extent of liability*

52. The Working Group was agreed that a holder, who took an instrument by mere delivery and in good faith, should be able to rely on the fact that the signatures on the instrument were genuine or authorized and that no material alteration had been made on it. Such reliance should be fully protected and it was irrelevant in this respect whether the person who transferred the instrument by mere delivery was with or without knowledge of such infirmities. On the other hand, the liability of the transferor by mere delivery should not be strict as regards the matters set forth in paragraph (1) (c) and (d) of article 41, namely that no party had a valid claim or defence against the transferor and that the instrument had not been dishonoured by non-acceptance or non-payment. Consequently, the liability in respect of the matters covered by paragraph (1) (c) and (d) should be conditioned upon knowledge of the transferor. One representative and one observer maintained the view that the liability of the transferor should be conditioned upon knowledge also in respect of those matters covered by paragraph (1) (a) and (b), namely forged or unauthorized signatures and material alteration.

53. The Working Group was agreed that the liability under article 41 should be incurred by a transferor by mere delivery only to his immediate transferee. One observer expressed the view that, if the transferor had knowledge of an infirmity attaching to the instrument and he failed to inform his transferee thereof, he was guilty of fraud and in such case his liability should extend to all subsequent transferees.

54. It was stated that the liability of the transferor by mere delivery could be defined in terms of damages and in terms of rescission of the contract between the transferor and the transferee. If the liability were for damages, the holder would have to prove the damages which he suffered because of an infirmity and would, at least under some legal systems, be obliged to mitigate those damages. Consequently, it could be held that where recourse was available to the holder against parties to the instrument, such recourse should be had in first instance before the right under article 41 could be exercised. Conversely, if the right of action under article 41 were conceived of in terms of rescission of the contract, the holder could proceed immediately against his transferor and, in such a case, would receive back the amount he paid for the instrument and any interest, against surrender of the instrument to the transferor.

55. The Working Group, after deliberation, was of the view that article 41 should not espouse either approach but should be drafted in such a way that the holder

would be given an immediate right of action against his transferor but would leave open the option of proceeding against parties liable on the instrument. It was noted that if the holder elected to proceed in first instance against a party liable on the instrument, he would still retain his right to proceed under article 41 if he had not obtained the full amount he was entitled to. The following example was given: the maker A issues a note for 1,000 Swiss francs to the payee B; B fraudulently alters the amount from 1,000 to 2,000 Swiss francs, endorses the note in blank and transfers it to C; C delivers the note to D, who has no knowledge of the alteration and is a protected holder. The prevailing view was that D had a right to recover from C 2,000 Swiss francs from the moment he learned about the alteration and it was in this respect irrelevant whether C, when he delivered the note to D, was with or without knowledge of the alteration, while under another view this result was doubtful since article 41 dealt with the issue of damages. Alternatively, at maturity of the note, D could enforce the note for 1,000 Swiss francs against the maker A and then recover, under article 41, 1,000 Swiss francs from C.

56. The Working Group considered the following revised draft of article 41 prepared by the representative of France:

"(1) Any person who transfers an instrument by mere delivery shall, in the absence of agreement to the contrary, warrant to the holder to whom it transfers the instrument that:

"(a) the instrument does not bear any forged or unauthorized signature;

"(b) the instrument was not materially altered;

"(c) no party has a valid claim to this instrument or defence against him;

"(d) the bill has not been dishonoured by non-acceptance or non-payment and the note has not been dishonoured by non-payment.

"(2) The warranty referred to in paragraph 1 (a) and (b) shall be due only if the defect concerning the instrument was not known to the holder to whom the instrument was transferred, regardless of any consideration of knowledge on the part of the person who transferred the instrument by mere delivery.

"It shall be due on account of the defects listed in paragraph 1 (c) and (d) only if the defect concerning the instrument was, on the one hand, known to the person who transferred it by mere delivery and, on the other hand, not known to the holder to whom this instrument was transferred.

"(3) The holder has the possibility either of exercising, before or after the maturity of the instrument, the claim under the warranty referred to above or of exercising, up to the due amount, against the parties obligated under the instrument and to the extent of their commitment, the recourse referred to in articles 55 *et seq.* or of claiming damages against the person responsible for the forgery or alteration or unauthorized signature.

"Except in respect of a claim against the person responsible for the forgery or alteration or unauthorized signature, the holder, particularly where multiple claims are exercised, may not receive a total sum which exceeds that of the amount of the instrument, plus interest on this amount at the rate of . . ."

57. The Working Group, after deliberation, adopted the revised draft text, subject to improvement of its drafting and the following modification of its paragraph (3). The Working Group was agreed that the amount which the holder may recover from a transferor by mere delivery under article 41 should be limited to the amount he paid, or the value he gave, for the instrument plus interest which, in a given case, may be less than the amount of the instrument. It was noted in this context that, as provided for in paragraph (1) of article 41, the transferor by mere delivery could exclude or limit his liability by agreement with the holder.

58. As regards the rate of interest, a proposal was made that the relevant rate should be the London interbank offered rate (LIBOR). The Working Group was agreed that the issue of the rate of interest should be dealt with at its next session.

59. The view was expressed that the liability of the transferor by mere delivery under article 41 should be conceived of in terms of damages and not in terms of warranties given by him. The Working Group requested the secretariat to review the above draft article 41 with a view to improving, in general, its wording and in particular to avoiding any reference to the concept of warranty since this term was not used in all legal systems.

C. *Extension of article 41 to endorsers*

60. Divergent views were expressed on the question whether the liability under article 41 should be extended to endorsers. Under one view, the undertaking of an endorser on the instrument was that he would pay the instrument in case of dishonour by non-acceptance or non-payment, provided that due presentment and protest had been made. Therefore, if the instrument was not accepted or not paid on one of the grounds listed in article 41 (1), the holder would obtain payment from the endorser because of the latter's undertaking. Thus, it was not necessary to extend the liability under article 41 to endorsers since, even without such remedy, the holder would be getting what he expected to receive when he took the instrument.

61. Under another view, if article 41 were not extended to endorsers, the liability of a transferor by mere delivery could in certain instances be more onerous than that of an endorser. Although it was true that a transferor by mere delivery did not warrant the solvency of prior parties, the transferee's right of action under article 41 was an immediate right which was available even before maturity, if he learned about the infirmity before maturity, and was moreover not conditioned by certain procedural steps which were

necessary for the liability of an endorser to materialize. In addition, considerations of policy which had been accepted in respect of the liability of a transferor by mere delivery, namely that the disparity of approaches in different legal systems would give rise to uncertainty, also applied to the liability of an endorser off the instrument for the infirmities listed in article 41 (1). In this connection, a view was expressed that the liability of an endorser who had signed the instrument "without recourse" was similar to the liability of a transferor by mere delivery.

62. The Working Group, after deliberation, failed to reach a consensus on this issue. In the light of this situation, a proposal was made that, if the draft Convention, following the prevailing view, would not deal with the liability of an endorser for the infirmities listed in article 41 (1), it should contain an express provision according to which such liability was left to the applicable national law.

63. The secretariat was requested to submit to the Working Group's next session a study examining the advantages and disadvantages of a rule in the Convention which would impose liability for the matters set forth in article 41 (1) upon an endorser. The secretariat was also requested to prepare, if deemed appropriate, alternative draft provisions in this respect.

IV. *Definition of knowledge (article 5)*

64. Different views were expressed on the definition of knowledge set forth in article 5. Under one view, the notion that a person is considered to have knowledge of a fact not only if he had actual knowledge of it but also if he could not have been unaware of its existence was unacceptable. The draft Convention should provide certainty and this could only be achieved by laying down that only actual knowledge constituted knowledge for the purposes of the Convention. Under another view, the provision of article 5 should be retained in its present wording since it would enable courts to deduce from the circumstances surrounding the case that a person should have had knowledge of a fact despite his denial of having knowledge of it. There could indeed be situations where ignorance of a fact was inexcusable. Furthermore, if the definition of knowledge were restricted to actual knowledge, it would, in certain circumstances, be extremely difficult to prove knowledge.

65. The view was expressed that even if knowledge were restricted to actual knowledge, courts would still have discretion to draw certain inferences from objective factors and to conclude that a person had knowledge though he denied having it. On the other hand the phrase "could not have been unaware of its existence" would permit a court to impute knowledge to a person who did not have actual knowledge because he had wilfully closed his eyes to relevant factors.

66. The Working Group considered a drafting proposal prepared by the representatives of Australia,

Czechoslovakia and the United States. The proposal was to replace, in article 5, the words "or could not have been unaware of its existence" by the words "or if he does not have actual knowledge because he unjustifiably disregarded facts or circumstances known to him". One observer expressed the view that the definition of knowledge should accommodate the possibility of presumed knowledge.

67. The Working Group, after an exchange of views, was agreed that, for the purposes of the Convention,

knowledge should in principle be actual knowledge; this should include the power of courts to deduce from the circumstances of the case that a person, despite his denial, had actual knowledge of a fact. However, the definition should go beyond that, without covering negligence, in that it should allow imputing knowledge to a person who did not have actual knowledge because he had wilfully disregarded relevant facts. The Working Group requested the secretariat to prepare for its next session a revised draft of article 5 which would implement this understanding.

B. Electronic Funds Transfers

Draft Legal Guide on electronic funds transfer: report of the Secretary-General (A/CN.9/266 and Add. 1 and 2)^a

[A/CN.9/266]

1. The Commission, at its fifteenth session in 1982, decided that the secretariat should begin the preparation of a legal guide on electronic funds transfers in co-operation with the UNCITRAL Study Group on International Payments.¹ It was decided that the Guide should be oriented towards providing guidance for legislators or lawyers preparing the rules governing particular systems. Several chapters of the draft Legal Guide were submitted to the Commission at its seventeenth session in 1984 for general observations.² The secretariat informed the Commission that two additional draft chapters would be submitted to the Commission at its eighteenth session.

2. There was general agreement in the Commission that the draft chapters before the Commission already constituted an excellent beginning to the work in this field and laid the basis for the development of an international common understanding of the legal issues involved. It was noted that it would be premature to

attempt to formulate uniform legal rules governing electronic funds transfers before an international common understanding on the subject had been reached. It was noted, however, that the establishment of such a common understanding through the Legal Guide might make it possible in the future to prepare concrete uniform rules in respect of certain aspects of electronic funds transfers.³ The Commission therefore requested the secretariat to complete the remaining draft chapters and decided that at its eighteenth session it would consider the course of action to be taken on this matter.⁴

3. Annexed to this report in addenda 1 and 2 are the remaining draft chapters of the Legal Guide: "Finality of funds transfers" and "Legal issues raised by electronic funds transfers". The Commission may wish to consider sending the full set of draft chapters to Governments and interested international organizations for comment, and requesting the secretariat, in co-operation with the UNCITRAL Study Group on International Payments, to revise the draft chapters in the light of the comments received for submission to the nineteenth session of the Commission in 1986 for adoption.

^aFor consideration by the Commission, see Report, chapter III, B (part one, A, above).

¹Report of the United Nations Commission on International Trade Law on the work of its fifteenth session, *Official Records of the General Assembly, Thirty-seventh Session, Supplement No. 17* (A/37/17), para. 73.

²The draft chapters are to be found in A/CN.9/250/Add.1-4.

³Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 92.

⁴*Ibid.*, para. 93.

[A/CN.9/266/Add.1]

Chapter on finality of funds transfer

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Introductory note

1. Finality of a funds transfer is often considered to be one of the important unifying concepts in the law of funds transfers. In many legal systems, important legal consequences are considered to occur at the time when the funds transfer becomes final. For this reason, concern has been expressed in banking and legal circles as to whether the time when an electronic funds transfer

becomes final is the same as or different from the time when a paper-based funds transfer becomes final. Furthermore, discussions of international funds transfers have often suggested the importance of finding a common understanding as to when an electronic funds transfer becomes final.

2. A comparison of the concept of finality in a number of legal systems shows that the concept is

imprecise. Although many legal systems refer to the finality of a funds transfer as occurring at a single point of time, there are several points of time when various aspects of the funds transfer may become final. A funds transfer often becomes final as to one or more of the banks implementing it at a different time from that when it becomes final as to the transferor and transferee.

3. This chapter is drafted on the basis that each of the legal consequences often associated with finality must be treated as a separate problem and the time at which that legal consequence occurs is determined by considerations relevant to it. Furthermore, it may be suggested that in the preparation of new rules to govern electronic funds transfers, and especially rules governing the relations between banks in domestic or international funds transfers, a similar approach would be desirable. Therefore, when a funds transfer is said to be "final" in this chapter, it should be understood to mean no more than that a certain number of legal consequences may have occurred in respect of that funds transfer, but that they are not necessarily the same as the legal consequences which may occur in any particular legal system.

A. When funds transfers become final

4. The time when a funds transfer is final, or when certain legal consequences occur, is normally associated with a specific action of a bank. There is a long list of actions by banks which are considered or which might be considered to make a funds transfer final in various countries. In the following paragraphs are discussed some of the more important of those actions. Other actions are usually variations of those discussed.

1. Credit transfers

(a) Debit to the account of the transferor

5. In one country (France) it has been held that one-bank and two-bank credit transfers are final, at least to the extent that the funds transfer instruction can no longer be withdrawn by the transferor, when the transferor's account is debited. It has been suggested that the funds transfer should also be considered final where insolvency proceedings are subsequently commenced against the transferor. The doctrinal explanation for legal finality of a credit transfer upon debit of the transferor's account is that the transferor thereby loses ownership of the funds. To the extent this rule is generalized to other consequences of finality, it leads to the result that in a one-bank transfer at a bank with multiple branches or in a two-bank transfer, the funds transfer could become final several days before the transferee's account was credited in fact.

6. However, no country is known to apply this reasoning to three-bank transfers. A reason often given in France for the different treatment is that in a three-bank transfer the funds are considered to be in the

hands of an agent of the transferor until the account of the transferee bank has been credited by the intermediary bank and, until that moment, the transferor can revoke the agency.

7. In many other banking systems it is not acceptable for funds transfers to become legally final for any purpose before the transferee bank has had the opportunity to exercise its judgment as to the acceptability of the settlement offered. In some countries the failure of a bank to settle for a domestic funds transfer may be a distinct possibility, and international funds transfers by their very nature raise the possibility that foreign transferor banks may be unable to fulfill their obligations. However, the settlement question need not affect the question of finality where the structure of the banking system precludes the possibility that transferee banks will not receive settlement, and particularly where all banks are owned by the State.

(b) Credit to the account of the transferee bank

8. If the credit transfer between the banks themselves is final when the transferee bank's account has been credited by the transferor bank or intermediary bank or has been credited at or through a clearing-house, and if the credit can no longer be reversed either by a withdrawal of the funds transfer instruction or by the sending bank's failure to settle, then the funds transfer may be considered to be legally final as to the transferor and transferee at the same time, i.e. when the transferee bank's account has been credited. In such a case the subsequent crediting of the transferee's account would have no effect on finality of the funds transfer. A somewhat similar result has often been reached in respect of paper-based transfers where the sending bank settled with the transferee bank by enclosing with the funds transfer instruction its own irrevocable commitment in such a form as a banker's cheque or banker's payment.

(c) Notice of credit to the account of the transferee bank

9. The above considerations apply if the credit transfer between the banks is final when notice of the credit to the transferee bank's account has been given to it and, thus, the funds transfer would be final as to the transferor and transferee when the notice is given to the transferee bank.

(d) Transferee bank decides to accept credit transfer

10. In many common law countries a credit transfer may become final at the moment the transferee bank decides to accept the credit transfer. This decision can be manifested by any act which demonstrates the transferee bank's intention and will be based upon its assessment of the reliability of the settlement offered in support of the credit balance it is asked to create.

11. Historically this rule had the advantage that the funds transfer became final at the earliest possible moment after the transferee bank had received the credit transfer instruction and had had the opportunity to perform the necessary verifications. As a result it may

have been the earliest point of time acceptable for finality of a funds transfer in which the transferee bank received the funds transfer instruction from a foreign country. The rule has the disadvantage that in case of dispute it calls for a judicial determination whether a particular employee of the bank had made a subjective judgment by a particular point of time, a determination which can be made only by the review of specific facts in each case. The rule, which was first formulated in respect of the honour of bills of exchange and cheques in an earlier era, may be less applicable to the finality of funds transfers in a period of batch-processing or on-line telecommunications.

(e) *Entry of credit to transferee's account*

12. In routine batch-processed credit transfers, no conscious decision to honour is made by the transferee bank, and the first objective act which can be relied upon to occur is the credit entry to the transferee's account. It is that objective act which is considered to make the funds transfer final in many legal systems.

13. However, although the entering of the credit to the transferee's account is an objective act, the point of time at which it occurs is often not determinable. When account records are kept in visual form, the order in which debits and credits are entered is discernible, even though the exact time at which they are entered may not later be determinable. When individual funds transfer instructions are received over computer-to-computer telecommunications and are released for posting after verification, the time of posting can be stored in the record of the transaction. However, individual paper-based and electronic funds transfer instructions processed in batch-mode are usually not time-stamped. Although time-stamping of the individual instruction is technically feasible, it may be questioned whether it would be a desirable requirement simply for the purposes of determining when the funds transfer became final. The same effective result might be achieved by considering the funds transfer final when the batch is introduced into the machine for processing or when it is taken out of the machine after processing, actions which are likely to be kept in a data-processing log.

14. Overnight posting with an entry date of the following day may raise a question as to whether the posting of a credit outside normal working hours legally takes effect immediately or only at the opening of business on the next banking day. If this is an issue in any legal system, it will become more acute as banking moves towards a twenty-four-hour day, not only in respect of international banking but also in respect of consumer banking through the full array of customer-activated terminals.

15. Posting with an interest date one or more days after the entry date raises a different issue. In many civil law countries, once the credit is posted the funds transfer is final and the transferee has an unqualified right to withdraw the funds. However, he does not earn interest on the credit until the interest date and, if the funds are withdrawn before the interest date, he would pay a fee equivalent to the prevailing rate of interest on loans from

the date of withdrawal to the interest date. Therefore, in these countries, transferee banks which receive a credit transfer before the pay date, i.e. the date specified by the transferor on which the funds are to be freely available to the transferee, may enter the credit immediately with an interest date which is the same as the pay date.

16. In common law countries a different result is likely. Where transfers show a future pay date, it is common practice to delay entry of the credit to the transferee's account until the day indicated, although the transaction may be entered into the transferee bank's computer at an earlier time for entry to the account on the pay date. Therefore, if finality is dependent upon entry of the credit to the transferee's account, the funds transfer would not become final until the pay date and the funds would not be available until then.

(f) *Entry of credit subject to reversal*

17. In some countries it is an acceptable banking procedure for banks to enter debits and credits to the accounts of their customers subject to reversal for a period of time. Although the procedure is followed in several countries, its most well-known use in respect of international funds transfers involves credit transfers made through CHIPS and similar on-line electronic clearing-houses in the United States with end-of-the-day (or next-day) net settlement. Since the CHIPS rules anticipate the possibility that one or more banks may fail to settle for their net debit balance, many banks participating in CHIPS provisionally credit their customers' accounts with incoming credit transfers as those transfers are received over the CHIPS system. However, the credits are subject to reversal if there should be a failure to settle. The provisional credits and the credit transfers become irrevocable when settlement is final. In other types of credit transfers where reversal may be allowed for a wider range of reasons, a provisional credit to the transferee's account may become irreversible when the time has passed during which the system allows reversal of the credit. Although irreversibility and finality are not synonymous terms, in these cases the funds transfer is usually considered to become final when the credit entry becomes irreversible.

(g) *Notice to the transferee*

18. In a number of legal systems a credit transfer is deemed to be final when a notice of the credit is given to the transferee. This is seen as the moment when the information that the transferee's account has been credited passes out of the control of the bank.

19. The rule is based on a practice of sending a notice of the credit at the end of the day or on the following day for every credit entered to a customer's account. However, if customers can inquire by on-line customer-activated terminals as to their account balance and recent account activity, application of this rule might lead to the conclusion that the credit was final as soon as it was posted to the account. In this case, there would no longer be a need to send a notice of the credit to the transferee for the purpose of making the funds transfer final.

(h) *Payment in cash*

20. When the transferee bank is to hand over cash to the transferee at such a place as his domicile or place of business, as is the practice in many consumer-oriented credit transfer networks and especially those operated by postal services, the funds transfer may be final upon the handing over of the cash. Therefore, it would seem that the funds transfer would not be final if the transferee refused to take the cash. The same result may occur when the transferee bank is to hold the funds for delivery in cash or equivalent to the transferee upon identification.

2. *Debit transfers*

21. Considering that debit transfers become final when the transferor bank takes the relevant action, the same general set of possible points of time at which a funds transfer becomes final exists in respect of debit transfers as exists in respect of credit transfers. That is, the funds transfer may become final when the transferor bank decides to honour the debit transfer instruction, when the debit to the transferor's account is entered, when a notice of the debit is given or when, subsequent to the posting of the debit to the account, the time allowed for reversal of the debit has passed.

22. There is, however, a major qualification to the general equivalence between the points of time when a debit transfer and a credit transfer may become final. A debit transfer is not final as a result of the crediting of the transferee's account. On the contrary, if the transferee's account is credited when the debit transfer instruction is first processed by the transferee bank, e.g. when a cheque is deposited, that credit will normally be provisional subject to reversal if the instruction is dishonoured. This result occurs even in legal systems which would hesitate to permit a transferee bank to reverse a credit to the account of a transferee in a credit transfer.

B. Relationship between finality of transfer between customers and finality of transfer between banks

23. A transfer of funds for the account of customers at different banks is implemented by a transfer of funds between the banks. Where settlement for a debit transfer is by means of provisional debits and credits, the inter-bank funds transfer is final when the funds transfer between the two customers is final. Where settlement is by means of a separate funds transfer from the transferor bank, the finality of that settlement transfer may be divorced from the finality of the customer transfer. However, the legal system may provide that the customer transfer is not final and may be reversed if the settlement does not become final.

24. The finality of the credit transfer between the banks, as distinguished from the transfer between the customers, creates significant theoretical and practical difficulties. Although the theoretical difficulties are the

same for credit transfers handled between banks in batches (usually small in value per instruction) and credit transfers handled between banks individually (often large in value per instruction), the practical difficulties exist almost exclusively with transfers handled individually.

25. Credit transfers handled individually, and especially large-value international transfers, may require the involvement of as many as six or seven banks. These banks may all be in a row, or some of them may be reimbursing banks. In a credit transfer each segment takes on most of the characteristics of a separate funds transfer between the pair of banks involved in that segment. In ISO/DIS 7982, this segment is referred to as a "funds transfer transaction". Each funds transfer transaction requires a separate credit transfer instruction and a means of settlement. However, the inter-bank rules governing the finality of the funds transfer transaction between the banks do not purport to be the rules governing the funds transfer as a whole of which the transaction is a segment.

26. The inter-bank rules governing the funds transfer transaction may be found in a bilateral agreement between the two banks, but they are often found in general agreements among banks, or in clearing-house or other network rules. These rules apply without regard to whether the sending bank is acting on its own behalf in making a payment (e.g. making a payment in connection with a foreign exchange transaction for its own account) or to implement the instruction of a non-bank customer of the sending bank, or of one of its correspondent banks. Similarly, the rules apply whether the credit is to be applied by the receiving bank to an obligation of the sending bank or of an earlier bank in the chain or whether the credit is to be entered to the account of a non-bank customer of the receiving bank or to the account of one of its correspondent banks, perhaps in turn for credit to the account of one of that bank's customers. The original source of a credit transfer, the ultimate transferee and the business purpose of the transfer affect the content of certain data fields in the funds transfer instruction; they do not, however, affect procedures for the funds transfer transaction, and especially the rules governing its finality.

27. As noted in paras. 8 and 9, the finality of the credit transfer between the transferor and transferee could depend on the finality of the funds transfer transaction between the banks. However, in many legal systems the funds transfer would not be final between the transferor and transferee until the appropriate act had been taken in respect of the transferee, e.g. sending a notice of the credit to the transferee. Thus, there might be a period of time when the funds transfer transaction was final between the two banks but the funds transfer was not final between the transferor and transferee. In other legal systems the funds transfer transaction between the two banks might not be final until the funds transfer between the transferor and transferee was final under the appropriate rule.

28. When there are three or more banks, the dichotomy between the funds transfer from transferor to transferee and the funds transfer transaction between each pair of banks becomes both clearer and more important. A three-or-more-bank large-value funds transfer often passes through an electronic clearing-house which has clearly defined rules as to the time when the transfer is final as regards the sending and receiving banks. When the sending and receiving banks are both intermediary banks in regard to the customer transfer, that intermediary segment of the funds transfer may be final even though the funds transfer must pass through one or more additional banks before it arrives at the transferee bank.

29. The finality of a funds transfer transaction between intermediary banks could be expected to terminate the right of the sending bank in that transaction to withdraw its funds transfer instruction. Therefore, once that funds transfer transaction had been completed, the sending bank's subsequent receipt of a notice that the transferor had withdrawn his funds transfer instruction would be too late to affect the transaction. For the same reason, notice of the death of the transferor, commencement of insolvency proceedings against him or attachment of his account would also be too late. This suggests that the receiving bank in the funds transfer transaction might also have no obligation to pass to its credit party any such notice it may have received. If this is the case, the legal effect of these various notices in respect of the funds transfer as a whole might also be terminated by the finality of an intermediate funds transfer transaction. In order to overcome this result, the transferor bank or sending bank might be required to send the notice directly to the transferee bank.

30. The early finality of a funds transfer transaction has the further effect of protecting the funds transfer process from the failure of an intermediary bank to settle for the transaction. This matter is discussed below in paras. 97 to 99 and in the annex.

C. Changes in technology affecting finality

31. Even before the advent of modern electronic funds transfer techniques, changes in the technology used to process paper-based funds transfer instructions had affected the rules governing the finality of funds transfers.

1. Individual processing of paper-based instructions

32. The traditional rules governing finality were developed in the context of individual processing of paper-based funds transfer instructions. The rules tended to be based on four factual assumptions which were more or less common to the majority of banking systems. These factual assumptions were that:

(a) Account records were kept in tangible and visible form at the bank or branch at which the account was maintained. For purposes of the rules governing

finality (as well as the rules governing the period of time within which the bank was required to act), the relevant actions took place at that branch.

(b) Each funds transfer instruction was processed both at the originating bank and at the destination bank as an individual item and not as part of a batch.

(c) The flow of work caused instructions to be verified and to be posted in the order they arrived at the branch and to be processed in a standard way culminating in posting the accounts and sending of notices, if any. At any given moment it was possible to know what verifications or decisions had been made with respect to a given funds transfer instruction, and by referring to the account record it was always possible to know the order in which the instructions had been received and honoured.

(d) The volume of transactions was small enough to permit taking all the steps necessary to honour or dishonour the debit and credit transfer instructions on the day they were received. Clearing-house rules often required any return items, e.g. dishonoured debit transfer instructions, to be returned on the same day, and rules on finality often permitted the reversal of entries on that same day, but not later. A cut-off time was sometimes established for instructions received too late in the day to permit processing on that same day. In such cases instructions received after the cut-off time could be treated as having been received the next day.

2. Batch-processing

33. The use of batch-processing techniques changes a number of the factual assumptions on which the traditional rules on finality were often based:

(a) In order to gain the operational efficiencies possible in batch-processing large volumes of transactions, centralized data processing facilities have been created. Account records are no longer kept at the individual branches of a bank. Performance of the relevant acts leading to honour or dishonour is often divided between the data processing centre and the branches.

(b) In order to create homogeneous batches with the necessary characteristics, instructions may be collected and transported to the data processing facility periodically, in some cases only at the end of the day. Funds transfer instructions which are to be executed on a fixed day may be sent in advance of the entry date to an automatic clearing-house or transferee bank for advance processing. There is no longer a fixed relationship between the point of time when a specific funds transfer instruction is received by the bank, when the crucial decisions are explicitly or implicitly made to honour it, when the entries in the account records are made and when the funds transfer becomes effective. Rules on finality which were based upon that fixed relationship become difficult to apply in practice.

(c) Batch-processing is designed for the inexpensive processing of large volumes of transactions rather than for their expeditious processing. Funds transfers which are intended to be executed on a particular day may be

processed in advance by the transferor bank, automatic clearing-house or transferee bank, sometimes many days prior to the effective date. A funds transfer instruction received during the day for current action may be processed that night. Only on the following day would the banking officials responsible for the customer accounts see the print-outs showing the record of transactions and new account balances. Rules on completion which anticipate all steps being taken on the day of receipt may, therefore, be difficult to apply with batch-processing.

3. *On-line data processing*

34. The introduction of on-line data processing restores some aspects of the previous routines whereby instructions were processed individually. When a bank processes fund transfers on-line, its computer verifies the authenticity of the instruction and the status of the affected accounts and concurrently enters debits and credits, whether provisional or not. As a result of on-line data processing:

(a) The on-line entry of debits and credits to accounts from multiple branches, as well as from off-premise locations, frees the rules on finality (and of time-limits) from the previous constraints linked to the physical location of the account record.

(b) Individual funds transfers are processed within the bank and the entries are made as individual items without waiting for the creation of batches with appropriate characteristics or for the physical transportation of the instructions to the data processing centre. The account records indicate permanently the order in which the on-line transactions took place, including the exact time if that is desired.

35. Where an on-line data processing system provides for the entry of the debits and credits directly into the relevant accounts, the factual situation in respect of the rules on finality would seem to be the same as if the entries had been made in the traditional fashion on paper account records, i.e. the determination as to whether the funds transfer was final for any purpose would depend on whether under the relevant rule the funds transfer was final on entry of the debit or credit, or at a different time.

36. In other cases on-line data processing systems enter debits and credits into provisional accounts. These accounts may subsequently be consolidated with the regular accounts when inter-bank settlement has been completed or at any other time deemed appropriate by the bank. In the meantime, the computer can be programmed to show the provisional account rather than the regular account in case of enquiry about account balance or account activity, so that the existence of provisional accounts may not be readily apparent even to many employees of the bank. However, until the debits and credits are consolidated into the regular accounts, the funds transfer may not be final under rules which are based on the time of entry.

37. A mixture of on-line and batch-processed entries makes it difficult to establish priorities between different funds transfers on the basis of the time of entry of the debits or credits. It may be further noted that funds transfer instructions which are processed on-line by the originating bank may nevertheless be transmitted off-line in batches to another bank or to an automatic clearing-house. In this case the receiving bank would probably process the instructions in batch-mode.

4. *Customer-activated terminals*

38. Off-line customer-activated terminals store the transaction data on computer memory devices for later batch-processing. In most cases the normal rules on finality applicable to batch-processed funds transfer instructions would be appropriate. However, the dispensing of cash from a cash dispenser, whether on-line or off-line, would probably be considered to be final at the moment the cash was withdrawn. In this case the debit to the account of the customer would constitute only an implementing act of record-keeping. This would be in accord with the rules governing time of finality of cheques or credit transfer instructions which are honoured in cash.

39. Although on-line point-of-sale systems permit the immediate entry of the credit to the merchant's (transferee's) account and debit to the purchaser's (transferor's) account, some point-of-sale systems which permit the on-line verification of the authenticity of the funds transfer instruction and the transferor's account balance delay debiting the transferor's account for one or more days to allow the transferor the same delay in debit which would previously have occurred if he had given the merchant a cheque. The credit to the merchant may also be delayed for a period of time, which may be the same as for the debit to the transferor. Thus, in most legal systems application of the usual rules would lead to the conclusion that the funds transfer was not final until the relevant entry date.

40. If only the debit was delayed, under certain rules on finality the funds transfer would be considered to be final if it was a credit transfer but not if it was a debit transfer. The opposite result would occur if only the credit was delayed. Determination as to whether the funds transfer was a debit transfer or a credit transfer might in turn depend on whether the funds transfer instruction from the point-of-sale terminal passed first through the purchaser's bank (credit transfer) or through the merchant's bank (debit transfer). However, if the funds transfer instruction went to a switch which simultaneously routed the credit to the merchant's bank and the debit to the purchaser's bank, the funds transfer could no longer be classified as either a debit transfer or a credit transfer, and this analytical basis for determining finality would not be available.

5. *Guarantee of honour by transferor bank*

41. Credit card plans, guaranteed cheque plans such as Eurocheque and electronic point-of-sale systems with delayed debit normally provide that, if the required procedures have been followed, the transferee (merchant) will be credited for the amount of the debit transfer instruction even though the instruction may turn out to be fraudulent. These procedures include a requirement that the transferor properly identify himself and may include a requirement that the transferee (merchant) receive an authorization from the transferor bank (or from the relevant network) before proceeding with the transaction.

42. Guarantee of honour creates a legal hybrid in the law of funds transfers. A direct result of the guarantee is that the transferor bank is irrevocably obligated under the contractual arrangements to the transferee and to the transferee bank to honour the debit transfer instruction when it is presented. A necessary additional element in the contractual arrangements is that the transferor relinquishes any right he would otherwise have under the applicable law of funds transfers to withdraw the debit transfer instruction. Where consumer legislation protects the right of the transferor to withdraw the debit transfer instruction for some period of time, thereby for that period of time precluding the transferor bank from irrevocably debiting his account in respect of that instruction, the transferor bank's guarantee to the transferee and transferee bank must necessarily be similarly limited.

43. However, where the transferor bank's guarantee is complete and irrevocable, the legal situation could be considered to be the equivalent of that following acceptance of a bill of exchange (or certification of a cheque, in those countries where certification is permitted). Furthermore, the legal situation would be similar to that found in many legal systems where a funds transfer is final at the time when the transferor bank has irrevocably committed itself to settling with the transferee bank by, for example, issuing to the transferee bank its own irrevocable funds transfer instruction such as a banker's cheque or banker's payment. If this comparison is made, other consequences associated with finality may be thought to occur arising out of a guarantee of honour, such as that the amount in the transferor's account subject to attachment would be reduced by the amount of the guaranteed transfer, even though the account had not yet been debited.

6. *Microcircuit cards*

44. Since microcircuit cards are not yet in general use for funds transfers, the effect of this new technology on finality rules must be purely speculative. However, it would seem that if the cards are used merely to give a more secure means of identifying the transferor than is currently available, the law governing funds transfers, including the finality rules, will not be directly affected. This would be true whether the funds transfer was on-line or off-line. Similarly, if an off-line system is used

and the card is programmed to authorize a given amount of purchases (undoubtedly with a guarantee of honour by the transferor bank) but the debit to the account of the transferor, and the credit to the account of the transferee, are entered only after the purchase has been made, the finality rules would seem to be those otherwise applicable where there is guarantee of honour.

45. A third funds transfer procedure using microcircuit cards raises more difficult questions in regard to the appropriate finality rules. Under this procedure the card is charged with a certain value by the transferor bank. The transferor may remit cash to the transferor bank, but usually his account is debited for that amount at the time when the card is charged. As the card is used to purchase goods or services, the amount of value available on the card is reduced by the merchants' point-of-sale terminals. The transferee (merchant) is credited by the transferee bank either on-line or, more likely, off-line for the amount of the purchase. Under this procedure, therefore, the entire funds transfer consists of two stages, the charging of the card with value and the use of the value in the card to purchase goods and services. These two stages may be viewed as two separate transactions or as one transaction taking place at two different times. Under either view the credit to the transferee's account would become final at the same time, i.e. only at the time of or after the purchase of the goods or services. However, the debit to the transferor's account could be considered final either at the time when the card was charged with value and the account was debited or at the time when the card was used to purchase the goods or services.

46. On the one hand the debit to the transferor's account could be considered to become final without regard to his use of the card if the charging of the card by the transferor bank and the related debiting of the transferor's account were considered to be the equivalent of a withdrawal of cash by the transferor or of a sale to him of traveler's cheques or non-monetary tokens for use in public transportation or public telephones. Although the transferor retains the same amount of monetary value, it is in a different form.

47. On the other hand the card could be considered to constitute an account of the transferor with the transferor bank in a special form. If this view of the transaction is taken, the card could be considered to constitute either a separate account or a special form of the original account. If the card constitutes a separate account, the debit to the original account would become final upon the charging of the card. The debit to the account contained in the card arising out of the purchase of goods or services would probably become final at the time of purchase when the value remaining in the card available for use by the transferor was reduced by the point-of-sale terminal. If the card constitutes a special form of the original account, the debit to the original account would become final at the time of purchase. In either case the unused value in the card would constitute a claim of the customer against the bank. It would seem that the bank could exercise

set-off for its claims against that value. Furthermore, that value would seem to be included in any attachment of the customer's claims against the bank and the bank would, therefore, be obligated to take steps to prevent further use of the card.

7. *Computer-to-computer telecommunication of funds transfer instructions*

48. The fact that funds transfer instructions are transmitted between banks by computer-to-computer telecommunication does not by itself affect the appropriateness of rules on finality. However, the increasing availability and decreasing cost of computer-to-computer telecommunication has been one of the causes of the large increase in the volume of funds being transferred, especially by the large-value networks. Customer use of cash management services, for example, creates funds transfers that would not have occurred at an earlier time. As a result, there is increased risk to the banking system and to the entire economy arising out of the large number of funds transfers which are not yet final. Some measures being considered to face this problem are discussed in paras. 97 to 99 and in the annex to this chapter.

D. *Consequences associated with finality*

1. *General rules giving priority to funds transfer*

49. Several general rules give the transferee rights to the credit arising out of the funds transfer prior to the transfer becoming final. The most inclusive of those general rules is the French rule that the issuance of a cheque transfers the *provision* to the holder of a cheque (i.e. the transferee). As a consequence of this rule, the transferee normally prevails over a third party claimant whose claim against the transferor's account arose after issue of the cheque. However, even though the transferee prevails over third party claimants, the funds transfer itself is not final until the cheque has been honoured.

50. A general rule of more limited application is that the transferor bank or an intermediary bank must be allowed to complete the funds transfer if it has irrevocably committed itself to honour the transferor's instruction. This may occur, for example, by the bank accepting a bill of exchange (or certifying a cheque if permitted by the relevant law). It may also occur when a transferor bank settles for a funds transfer by issuing its own irrevocable promise to pay, such as a banker's cheque or banker's payment. The policy that lies behind this rule is that the bank which is committed to honour the funds transfer instruction or to settle for it should be able to reimburse itself from the transferor's account in spite of the intervening creation of third party rights in the account. This policy would also seem to be applicable to funds transfers made through a clearing-house if the sending bank guarantees settlement to the receiving bank and to guarantee-of-honour plans for debit transfer instructions, as discussed in paras. 41 to 43.

2. *Specific conflicts in priority*

(a) *Effect on funds transfer of legal rights of third persons*

51. The legal rules governing the effect on the transferor's account of his death, the commencement of insolvency proceedings against him or attachment of the account are largely or completely found outside the law governing funds transfers. These legal rules create rights in third persons which may compete with the rights claimed by the transferee. As a result, it is often difficult to reconcile the law governing the third party right and the law governing the funds transfer itself.

52. The conflict in priority between the third party right and rights arising out of the funds transfer can arise in several ways. The most direct source of conflict is between the third party claimant and the transferee who claims that the funds transfer was final before the third party right arose. If the transferee has already used the credit, the claim of the transferee may be asserted by the transferee bank. In many cases, the immediate conflict is between the third party claimant and the transferor bank, which claims that the third party's rights in the transferor's account arose after the credit had already been transferred from that account. This is of particular importance to a transferor bank which has little likelihood of recovering the credit from the transferee.

(i) *Death of the transferor*

53. In some legal systems the death of the transferor may terminate all authority to act on his behalf or under his instructions at the moment the death occurs. Although this rule is often explained as an automatic termination of the agency relationship between the transferor and the bank or banks implementing the funds transfer, it would also seem to be applicable in those legal systems where the bank or banks carrying out the funds transfer on the transferor's instructions are not considered to be his agent. However, in many legal systems the bank's authority is terminated only by notice to it of the death. Furthermore, since the transferor is solvent at the time of death in the vast majority of cases and the funds transfer is usually for the purpose of discharging an obligation which would need to be discharged even after his death, some legal systems permit the transferor bank to continue to honour the transferor's funds transfer instructions for a period of time even after notice of his death unless ordered to stop doing so by an heir or, in some other countries, any person claiming an interest in the account.

(ii) *Commencement of insolvency proceedings against transferor*

54. The commencement of insolvency proceedings against the transferor creates a more complex legal situation than does his death because of the wide variety of rules governing insolvency in different countries. This causes particularly difficult legal problems for a transferee who is resident in a country foreign to the place where the insolvency proceedings against the transferor are taking place. However, one element in

common with the legal situation caused by the death of the transferor is that the commencement of insolvency proceedings normally terminates the transferor bank's authority to honour any funds transfer instructions which have not already become final. Because of the strong policy to preserve the insolvent's remaining assets for distribution to creditors in accordance with the statutory priorities, in some countries the transferor bank's authority to honour funds transfer instructions terminates when the insolvency proceedings are begun, even though the bank may have no notice of those proceedings.

(iii) *Legal incapacity of transferor*

55. A transferor may not yet have legal capacity to issue funds transfer instructions or may lose legal capacity because of the conviction of certain crimes, declaration of mental incompetence, declaration of receivership or for similar reasons. Where the legal incapacity arises out of minority, declaration of mental incompetence or the like, the desire to protect the incapable person from his own acts may require the reversal of funds transfers which otherwise appear to be final. Where the transferor is legally incapable because of conviction of a crime, it would seem incongruous not to allow the transferee to benefit from a funds transfer in process.

(iv) *Attachment of the transferor's account*

56. Attachment of the transferor's account normally takes effect upon notice to the transferor bank. Except in the case of the issue of a cheque in France by which the *provision* is transferred to the holder of the cheque, the attachment would normally take priority over a debit transfer which had not become final before the legal process took effect. However, where the debit to the transferor's account is first entered provisionally, attachment of the account during the period of reversibility may be too late even though the funds transfer may not yet be considered final.

57. In the case of a credit transfer, in some legal systems the legal process would be too late if the transferor's account had already been debited. However, in other legal systems, since the credit transfer would not be final upon the mere entry of the debit to the transferor's account, the credit might be considered still to be subject to the legal process. In such a case, the transferor bank would have to use reasonable efforts to stop the completion of the credit transfer by notifying the transferee bank of the legal process.

58. Difficult questions may be raised as to the transferor bank's obligation for a credit transfer made through an intermediary bank. Since the transferor bank knows the name of the transferee bank and all the details of the transfer, it could send the notice directly to the transferee bank. However, since there is no direct relationship between the transferor bank and the transferee bank when intermediary banks have been used, it may not be clear what obligation the transferee bank would have to act upon the notice given by the transferor bank. These problems would be particularly

difficult in the case of an international funds transfer where the transferor bank and transferee bank may be subject to different rules on finality and where intermediate portions of the funds transfer may have become final under the rules governing funds transfer transactions between the intermediary banks.

59. As a result it could be expected that the transferor bank might have to make reasonable efforts to stop the completion of the funds transfer or, if no such efforts were made, to show that they would have failed.

(v) *Withdrawal of funds transfer instruction by transferor*

60. In accordance with general legal principles, a person may withdraw (or revoke) instructions or authority to act which he has given to another until such time as the instructions or authority have been acted upon. Under these principles, in some countries the transferor may withdraw from the transferor bank the authority to honour a funds transfer instruction up to the moment the transfer is final. However, the authority or instructions may be irrevocable if they have been expressly stated to be so. Where the agency is for the benefit of a third person or of the agent himself, the right of the principal to withdraw the authority to act may be limited so as to protect the agent or third person. Therefore, since a standing authorization to debit may be for the benefit of the transferee, the transferor might need the agreement of the transferee to withdraw the authorization or the transferee may need to be given adequate notice so as to be sure he can receive the money due to him. When the bank itself is the beneficiary, the authority to debit may be irrevocable without the agreement of the bank.

61. The withdrawal of a funds transfer instruction by the transferor creates many of the same problems for the transferor bank as does the withdrawal of authority to honour the funds transfer instruction by reason of the appearance of third party rights. In both cases the transferor bank must notify its own personnel of the withdrawal of authority and, in the case of a credit transfer, it may be required to attempt to notify the transferee bank not to credit the transferee's account.

(b) *Notices given to a bank*

62. Rules which terminate the bank's authority to act upon notice to the bank may also indicate the form of the notice and the information which must be contained in it, the person to receive the notice for the bank and whether the notice has an immediate effect upon the bank's authority to act or whether the bank has time to communicate the notice internally.

63. In some legal systems an oral notice of death, of the commencement of insolvency proceedings or of the withdrawal of a funds transfer instruction may be sufficient to require the bank to stop any funds transfers in progress. The oral notice may be valid for a limited period of time and be subject to confirmation by a later written notice. In most legal systems a written notice of withdrawal of a funds transfer instruction may

be informal and may be communicated by telecommunications. Attachment of an account would always be in a formal legal writing.

64. A notice given to a transferor bank that all funds transfers by a particular transferor are to be stopped need only indicate accurately the account or accounts affected by the notice. In the case of a credit transfer where the transferor bank may be required to notify other banks of the death, commencement of insolvency proceedings or attachment, the transferor bank itself would have all of the relevant information.

65. A notice by a transferor withdrawing only one or more specific funds transfer instructions must be more precise since it must describe the affected funds transfer instruction or instructions with reasonable precision as well as identify the account. This requirement can cause serious difficulties where large numbers of instructions are issued against the account or where the account records are kept on computers. A notice containing a typographical or other error might, nevertheless, be sufficient to alert a bank clerk working with account records in visible form. However, because of the similarity of data on many funds transfer instructions, if the notice of withdrawal as entered into the computer does not accord exactly with the funds transfer instruction on all material particulars, the computer may be unable to locate the instruction in question except by initially rejecting all funds transfer instructions which are similar to the one being withdrawn and subjecting them to individual review by bank staff. Such a procedure may be excessively expensive.

66. Any of the notices to a bank under discussion may have legal effect only as of the time when it is given to the bank. Where the bank has multiple branches, the notice may need to be given to the branch where the account is maintained. Unless the appropriate person to receive the notice is actually the person required to implement it, the bank will need a reasonable period of time to communicate the notice within the bank before it can have any practical effect, whether or not the notice may be legally effective prior to that time. Furthermore, if implementation of the notice requires its communication to other banks, an additional period of time may be required for this purpose. This need for time to communicate the notice within the bank or to another bank may be recognized by the law in determining the time at which the notice has legal effect.

67. The time to be allowed for the bank to communicate the notice before the notice becomes legally effective can be phrased only in general terms, such as the amount of time which any bank would reasonably need to communicate the notice, or as the amount of time which a bank would reasonably need in the light of its own existing internal communication system. The general installation by banks of on-line access to their customer account records would reduce the period of time allowed for all banks to communicate notices.

68. One effect of off-line batch-processing of funds transfer instructions is to decrease the likelihood that a

bank (or automatic clearing-house) will be able to withdraw a specific funds transfer instruction from the processing after receipt of a notice to do so. Since most off-line batch-processing systems do not permit the economical search for an individual instruction, automatic clearing-houses often do not permit the withdrawal of an instruction once the computer memory devices have been delivered or communicated to them, though some permit withdrawal for a period of time before processing begins. Similarly, the rules governing submission of debit transfer instructions pursuant to standing authorizations to debit often do not permit withdrawal of the authorization for a specific period of time prior to the scheduled submission of the debit transfer instruction. However, where the batched funds transfer instructions are contained on optical disks, the previous difficulties in searching for individual funds transfer instructions no longer exist. As a result, it has become technically feasible to allow withdrawal of the instruction for a longer period of time. This new technical possibility may be recognized in the rules governing the time until which a funds transfer instruction may be withdrawn by the transferor or transferor bank.

3. *Reversal of erroneous funds transfers*

69. After a bank has debited the transferor's account or credited the transferee's account, it may subsequently learn that it has made an error in carrying out the funds transfer, or that another bank or other participant in the funds transfer has made such an error. The question arises whether the bank may rectify the error or whether it is precluded from doing so because of the finality of the funds transfer.

70. Legal rules which delay the point of time at which the funds transfer becomes final give banks additional time to discover the problem and to dishonour the instruction before the transfer is final. As has been noted above, one means of delaying finality is to permit banks to enter debits and credits provisionally until the bank has verified the authenticity of the funds transfer instruction, the accuracy of the data processing and the assurance that the bank will receive value from its debit party. Once the funds transfer is final, the reversal of the debits or credits entered by the banks is subject to varying degrees of restriction.

(a) *Reversal of debit on demand of transferor*

71. A transferor bank which has received a notice that there has been fraud committed in the issue of funds transfer instructions is normally responsible for the loss caused by its subsequent honour of them. However, the transferor bank is not required to reverse the debits to the transferor's account in respect of those funds transfers which have already become final. In such cases, the bank is protected to a greater or lesser extent by principles of law of general application, placing the liability for the loss as between the transferor and the bank in whole or in part on the transferor. For example, if a dishonest employee of the transferor has caused a series of fraudulent funds transfer instructions to be issued, the transferor may have the right to

instruct the bank not to honour those instructions which have not yet been honoured but not have the right to require the bank to reverse the debits to his account in regard to those instructions which have been honoured.

72. A special problem arises when the transferor notifies the transferor bank in an appropriate manner and at an appropriate time that he is withdrawing the funds transfer instruction but the transferor bank subsequently honours it by mistake. A variation of this problem arises when the transferor bank has already sent a credit transfer instruction to the next bank in the chain prior to withdrawal of the instruction by the transferor and the bank does not take the necessary steps to prevent the transferee bank from honouring it. Even though the transferor may be acting properly within the legal rules, it may be thought that his issue of a funds transfer instruction and his subsequent withdrawal of it create a situation in which the transferor bank is subjected to a higher than ordinary risk of making an error. Furthermore, if the transferor owed to the transferee the amount transferred, in many legal systems completion of the funds transfer would be considered to discharge that obligation, even if the legal rules permitted the transferor to withdraw his instruction before it was honoured.

73. One approach to this situation emphasizes that banks must follow the proper instructions of their customers. Therefore, when a funds transfer instruction has been withdrawn in due time and in the proper manner, the transferor bank should be required to reverse any debit entered to the transferor's account. In addition, since no value has been transferred from the transferor's account, any credit already entered to the transferee's account should also be reversed. Otherwise, the transferor would have the benefit of discharging his obligation to the transferee without being charged for it. Reversing both the debit to the transferor's account and the credit to the transferee's account restores all parties to the situation they would have been in if the transferor bank had acted upon the transferor's withdrawal of the funds transfer instruction. However, if the funds transfer was for the purpose of discharging a valid obligation owed by the transferor to the transferee, the obligation would remain and would need to be discharged by a subsequent funds transfer. Therefore, a second approach is that, although the transferor bank would in principle be required to reverse the debit to the transferor's account, if the bank showed that the transferee was authorized as against the transferor to retain the funds, it could maintain the debit to the transferor's account.

(b) *Recovery of credit in a debit transfer on demand of transferor bank*

74. Except for the relatively few debit transfer instructions which are sent to the transferor bank for collection only, a transferor bank normally gives provisional credit to a presenting bank for all debit transfer instructions presented. This provisional credit does not signify finality of the funds transfer. There-

fore, the provisional credit may be reversed if the debit transfer instruction is dishonoured in the proper manner and within the allowable period of time.

75. Furthermore, in the vast majority of cases in which the transferor bank could have dishonoured a paper-based debit transfer instruction, it has the right to recover the credit from the presenting bank (and therefore from the transferee) even though the funds transfer has become final. The major exception is that in most countries the transferor bank may not recover a credit which has become final on the grounds that the balance in the transferor's account was insufficient when the debit to that account was entered. Moreover, in common law countries, as well as in some civil law countries, the transferor bank may not reverse the credit given to certain good-faith parties in honour of a cheque or bill of exchange bearing a forgery of its customer's signature as drawer. In these countries the truncation of cheques with electronic presentation raises the question whether the transferor bank will be bound by this general rule or whether the law should be changed to relieve the transferor bank of that responsibility.

76. This latter problem is raised in a somewhat different way in connection with debit transfers made pursuant to a standing authorization to debit. If the authorization is lodged with the transferee bank or with the transferor, both of which are common in some countries, the transferor bank has no way to know whether the debit transfer instruction is properly authorized unless the transferor complains about the debit to his account when he receives a statement of account activity covering the period in question. Therefore, it is common in such schemes for the transferee bank to guarantee to the transferor bank that the debit transfer instruction is properly authorized and that it will reimburse the transferor bank for any challenged transfers. In turn, the transferee is required to guarantee reimbursement to the transferee bank.

(c) *Recovery of credit in a credit transfer*

77. In many legal systems, once the funds transfer is final, the transferee bank may not reverse the credit to the transferee's account on the grounds it has failed to receive settlement. If, at the time the transferee bank makes the credit available to the transferee, there is any doubt whether settlement will occur, the credit may be entered provisionally, or other means may be taken to prevent the funds transfer from becoming final.

78. In several countries in which credit transfers have not been the normal means of inter-bank funds transfers, doubts have been expressed whether appropriate legal theories exist to enable the transferee bank to recover from the transferor a credit entered in error. Credits entered in error occur, for example, by the transferee bank crediting an amount greater than the correct amount, crediting the same transfer twice or crediting the wrong account. Nevertheless, in most legal systems it is clear that, in general, the credits established in error can be recovered by the transferee bank. In

some legal systems a bank has the right to correct credit entries it has made in error by debiting the transferee's account even though the credit has become final but may correct errors made by a transferor or a sending bank only with the express permission of the transferee.

(d) *Right of bank to recover credit by reversing entry*

79. In some countries a bank has the right to reimburse itself for a credit entered in error by reversing the credit without the express permission of the transferee. This right may exist for a limited number of days after the funds transfer is final or until the transferee has been notified of the credit. Exceptionally, the bank's unilateral right to correct errors may be unlimited in point of time. However, in many legal systems, the transferee bank may be allowed to correct the error by reversing the credit only with the express permission of the transferee. If the transferee does not give its permission, the transferee bank might obtain reimbursement only by taking legal action.

80. The right of a transferor bank or intermediary bank to correct an error by reversing a credit is essentially the same as that of the transferee bank. However, such a bank may be precluded from reversing the credit to the receiving bank without its permission unless either the receiving bank has not as yet credited its credit party or it can secure reimbursement from the credit party. In some cases, rules of finality governing the funds transfer transaction between two intermediary banks may preclude reimbursement by reversal of the credit even though the funds transfer between transferor and transferee is not yet final.

4. *Availability of funds*

81. Although there may be no direct legal connection between the finality of a funds transfer and the availability of the funds to the transferee, the finality of the transfer as to the transferee is usually one of the factors determining the time when the funds are made available. It is also important to distinguish between the time when the funds are available to the transferee bank and the time when they are available to the transferee. The time when funds are available to the transferee should also be distinguished from the time when those funds begin to accrue interest. In some banking systems the two points of time coincide, but in many other banking systems funds may be available for use for one or more days before they begin to earn interest in the account. In other banking systems funds may begin to earn interest in the account before they are available to the customer for use.

82. Any rules on availability could be expected to provide the transferee bank sufficient time to process the funds transfer instructions. Therefore, even a deposit of cash in an account may not give rise to a right to draw on the resulting credit until the following day if the deposit voucher would not be posted until after the close of business. The use of on-line terminals for many funds transfer activities, including the receipt

of deposits, may remove this basis for delay in availability in some banks. However, a deposit of cash in an automatic teller machine, even if recorded on-line by the depositor, would normally not be available immediately because of the bank's need to have its personnel count and verify the deposit.

83. The time when funds are made available to a transferee is usually determined by the practice of the transferee bank and is seldom governed either by the contract between the transferee and his bank or by provisions of law. However, in some cases, and particularly in regard to those accounts from or to which large-value transfers are made or which are part of a cash management programme, individual contracts may be negotiated covering, among other matters, the time when funds will be made available to the customer. The maximum periods of time before which the funds must be made available in certain types of funds transfers have been established by law in a few States.

84. Although the availability of funds to the transferee is of primary interest to the transferee, it may also be of interest to the transferor who, for a variety of reasons, may need to be sure that the funds are at the free disposal of the transferee by a particular time. The transferor has little control over the time at which the funds will be available to the transferee in a debit transfer, since it is the transferee who initiates the funds transfer process with his bank. The transferor has more control in a credit transfer since he chooses the date on which the funds transfer begins and since he may be able to specify a "pay date".

85. The legal significance of the pay date in a credit transfer is unclear. As noted in the discussion on the period of time within which a bank must act on the funds transfer instruction, if the definition in ISO/DIS/7982 that the pay date is the "date on which the funds are to be available to the beneficiary [transferee] for withdrawal in cash" is part of the contract governing the funds transfer, it would seem to create a legal obligation to the transferor, and perhaps to the transferee, on the part of the transferor bank. The definition would more clearly create an obligation between the transferor bank and the next bank in the chain, and between each subsequent pair of banks through to the transferee bank. However, it may be unclear in many legal systems whether the transferee bank could be legally bound by the pay date either to the transferor, with whom the bank may be considered to have no legal relationship, or to the transferee. It may be thought that the transferee bank's obligation to the transferee as to when funds should be made available arises out of the relationship between them and not out of the instructions originally emanating from the transferor. In any case, it would seem that the transferee bank should not be obligated by the specification of a pay date if it has not received both the funds transfer instruction and settlement satisfactory to it in sufficient time, unless it has undertaken a more stringent obligation in some appropriate form.

86. Once the transferee bank in a credit transfer has received both the credit transfer instruction and settlement, the funds should normally be available to the transferee promptly since the transferee bank runs no further credit risk. However, if the credit transfer instruction and settlement arrive before the pay date, it is a common practice in common law countries for the transferee bank to delay entry of the credit and availability of the funds until the pay date.

87. Rules on availability of funds in debit transfers must differentiate between debit transfer instructions, such as many bills of exchange, for which the transferee bank will give credit only after it has received notification of honour and the funds have been remitted to it, and debit transfer instructions for which provisional settlement is given between the banks and notification is given only in case of dishonour. Transferees of the first type of debit transfer instruction know that the funds will not be available before their bank receives notice of honour and the remittance of funds. In the second type of debit transfer instruction, which represents the vast bulk of all paper-based and electronic debit transfers, appropriate rules on availability are more difficult to formulate. The instructions are handled in bulk throughout the funds transfer process. The applicable rules, which should take into account such matters as the period of time before the banks receive settlement, the period of time before the debit transfer instructions should normally be honoured and the period of time before information that there has been dishonour should normally be received by the transferee bank, can be based only on averages for the type of instruction in question and the experience of those using the system.

88. In most banking systems settlement for debit transfer instructions of this second type is made by provisional debits and credits through appropriate inter-bank accounts. The settlement may be immediate or it may be delayed for a specified period of time but the date when it is available to the bank is always predictable for each batch of debit transfer instructions of a similar type.

89. For paper-based debit transfers, the least predictable element is the period of time before information that there has been dishonour is received by the transferee bank. In some countries a transferor bank may have an indefinite period of time after receipt of a debit transfer instruction in which to dishonour it. Where the instruction itself must be returned through the same clearing channels through which it was presented, in some countries the period of time for it to be returned to the transferee bank can be several times the period of time necessary for it to be presented. Since delaying availability of the funds because of the possibility that the instruction may be dishonoured may delay availability for an excessive period for the vast majority of instructions that are honoured, actions to reduce this period of time may be desirable. Guarantee of honour by the transferor bank eliminates the possibility of dishonour. Cheque truncation with electronic presentment would serve to reduce the period of time for

presentment in many countries. The period of time after presentment during which a transferor bank could dishonour an instruction for insufficient funds could be strictly limited. A notice of dishonour could be sent by mail or by telecommunications directly to the transferee (depository) bank, even if it was necessary to return the debit transfer instruction itself through the clearing channel.

90. Electronic debit transfers present somewhat different problems for estimating the period of time before information that there has been dishonour will be received by the transferee bank. In general, as indicated in paragraph 88, electronic presentment of debit transfer instructions would serve to reduce the time for presentment. Furthermore, the system can be designed in such a manner as to facilitate the prompt return of dishonoured instructions. However, when an electronic debit transfer arises out of cheque truncation or pursuant to a standing authorization to debit where the authorization is lodged with the transferee or with the transferee bank, the transferor bank has no means to verify the authenticity of the debit transfer instruction. Therefore, until the transferor has received the relevant statement of account activity and the period of time for objection to unauthorized debits has passed, the possibility exists that the transferor will claim that the instruction was not authorized or that no authorization to honour the instruction existed. In some countries where only the passage of the statute of limitations or period of prescription cuts off the transferor's rights to object that a debit to his account was not authorized, the period of uncertainty may last for a period of years. For this reason it is advisable wherever possible for the authorization to debit to be lodged with the transferor bank.

91. Where the transferee is well-known to the transferee bank and there is little doubt that the transferee will be able to reimburse the transferee bank for any dishonoured debit transfer instructions, the bank incurs no substantial risk in making the funds available at an early date. Therefore, there is usually less delay in availability in respect of debit transfers made pursuant to a standing authorization to debit, where transferees are typically large and financially secure organizations, than there is in respect of other forms of debit transfer.

5. Discharge of the underlying obligation

92. Ultimately an underlying obligation is discharged by means of a funds transfer only if the transferee-creditor receives irrevocable credit in his account. However, the time when the obligation is discharged depends on the terms of the contract or other source of the obligation, the law governing the obligation and the funds transfer procedure followed.

93. In a relatively few, but usually important, contracts, the transferor is obligated to make the funds freely available to the transferee by a designated date. In some countries it has been the practice to treat primary obligations of a bank, such as a banker's

cheque or banker's payment, as satisfying such an obligation, but it is becoming the general practice to use a credit transfer with a specified pay date or even a specified time of day.

94. If the time when the funds must be freely available is not specified in the contract, an obligation discharged by credit transfer is normally discharged when the credit transfer becomes final as to the transferee. Therefore, recent changes in credit transfer procedures due to the increased use of electronic techniques could be expected to affect both the rules on discharge and the rules on finality. Indeed, it appears that in some recent cases the rules on finality of the funds transfer have been influenced by problems which have first arisen in connection with discharge of the obligation.

95. Since the obligation is usually discharged when the credit transfer becomes final, as between the transferor and the transferee it is the transferor who runs the risk of delays or errors in the funds transfer process. In some countries, the courts have relieved transferors from the most serious consequences of such delays by holding that insurance contracts or the like could not be terminated for late payment when the transferor had taken the appropriate actions to transfer the funds and had done so in due time. When the only consequence to the transferor arising of a late payment due to delays in the funds transfer process is loss of interest, the loss is often recoverable from the bank responsible. However, when the consequence is termination of the contract, banks have often been held not to be liable for the resulting damages.

96. Where the underlying obligation is to be discharged by a debit transfer, the transferee may not treat the obligation as being in default if he has the means to start the debit transfer process. Therefore, the issue as to when the underlying obligation was discharged seldom arises in the case of debit transfers where the transferee issues the debit transfer instruction, such as in the case of bills of exchange drawn by the transferee on the transferor or on the transferor bank or debit transfers made pursuant to a standing authorization to debit. Similarly, in the case of a cheque, the transferee may not treat the obligation as being in default once he receives possession of the cheque. In some countries there is a question whether the transferor may be liable to the transferee for interest as a result of remitting a cheque at such time that the transferee does not receive credit until after the date payment was due. However, in all cases of debit transfer it is the transferee who bears the risk as against the transferor of delays or errors in the funds transfer process. Although the debit transfer instruction must be honoured when presented for the underlying obligation to be irrevocably discharged, the time when it is honoured is of no practical significance in respect of the underlying obligation.

E. Rules on finality and system risk

97. System risk is the danger that the banking system as a whole will be severely damaged by the failure of

one or more banks to settle for the transfers they have made. A failure to settle is almost always a consequence of problems external to the funds transfer process. However, the recent development of on-line high-value net settlement electronic clearing-houses, through which participating banks often send in one-day funds transfer instructions for more than their entire capital and surplus, increases the risk that a bank will end the day with a debit balance for which it cannot settle. Furthermore, the larger the debit balance for which a bank fails to settle, the greater the impact on the other banks in the clearing-house, on the banking system and on the economy in general.

98. The extent to which a banking system can absorb a bank's failure to settle depends not only on the size of the debit balance for which it fails to settle, but also on the allocation of the loss between the other participants in the funds transfer system, including the non-bank customers of the banks involved. Among the rules allocating loss to the participants in the funds transfer system are the rules governing finality. In turn, the rules governing finality of large-value funds transfers have an important effect on the financial markets and large commercial transactions for which these transfers are made.

99. The public discussion of the issue has been concentrated in the United States, where there are several on-line large-value systems in operation. The fact that these systems have different finality rules leads to different possibilities and techniques for limiting system risk. The issue has also been addressed in the United Kingdom, where the nature of the banking system has led to yet other solutions to the problem. Because the discussion must of necessity treat the issue separately for each country, it has been placed in the annex to this chapter.

ANNEX

National experience in reducing system risk

A. The nature of the problem

1. In general

1. High-value electronic funds transfers, which are at present usually credit transfers, are likely to create risk for several reasons. The most obvious is that the value of the individual transfers, the total value of transfers made in a day and, most importantly, the size of the net debit or credit balance of an individual bank with any other bank or with the banking system as a whole during or at the end of the day are greatly increased. A second important reason is that, since transferors are more interested in having their large-value funds transfers completed quickly, large-value transfers are generally made as same-day transfers. As a result, the time allowable before settlement has been shortened and banks have less time than in earlier days to mobilize funds to meet their debit balances. Foreign banks, or local branches of foreign banks, may have more difficulties than domestic banks in funding their positions, especially if the foreign banks cannot obtain credit from the central bank.

2. Correspondent bank settlement

2. High-value credit transfers made through correspondent bank relationships can offer rapid settlement with little or no system risk under most circumstances. When the receiving bank receives value from the sending bank at the same time that it receives the credit transfer instruction, which is typical when the banks maintain accounts with one another, the receiving bank can give irrevocable credit to the credit party immediately without risk. When the receiving bank does not receive value immediately, it may have the right to delay honouring the funds transfer instruction until it receives value, collateral is given or there is a guarantee of reimbursement from a reputable source. Since there is no unsecured extension of credit arising out of the funds transfer, there is no risk to the receiving bank and, therefore, no system risk. However, this conclusion is subject to the important qualification that, when the receiving bank is the account-servicing bank and the instructions to debit or credit the account of the sending bank, i.e. the account owner bank, are sent or received by a number of departments of the receiving bank in addition to the funds transfer department, it can make rational credit decisions only if all its departments report all transactions promptly. When large sums of money are involved, this may call for transactions from all departments to be entered in real-time to the account.

3. Some correspondent bank relationships require the receiving bank to give irrevocable credit to the credit party before receiving value. This may occur, for example, because the pattern of funds transfers calls for certain banks to send more funds transfer instructions than they receive early in the day and to receive more than they send late in the day. Although these banks may regularly carry substantial credit balances at the end of the day, they may also regularly carry substantial debit balances during the day. In this case, passage of high-value credit transfers through correspondent bank relationships may create significant system risk.

3. Net settlement

4. A net settlement network is in many respects an arrangement for a series of correspondent bank relationships between each pair of banks in the network made through a single switch. However, there are several institutional features which may increase system risk in comparison with pure correspondent bank relationships. Since there is no mechanism in a net settlement network for the sending bank to give value to the receiving bank prior to settlement, at any point of time during the day one bank necessarily has a debit balance with the other bank. Furthermore, since the creation of a debit balance arises out of the receipt of credit transfer instructions, as well as by the sending of debit transfer instructions, no bank in the network can know until the end of the day whether it will finish the day with a debit or a credit balance with any other bank, even if it were to know the total amount of credits it would send to that other bank during the day. As a result, a bank which adopted a policy of not giving irrevocable credit on a credit transfer until it knew it had value, could act on instructions it received only to the extent it had already sent credit transfer instructions to the other bank. An alternative policy, which would permit receiving banks to give immediate irrevocable credit to a larger proportion of credit transfer instructions it received, would be for each bank to establish an upper limit of the net intra-day debit balance it would allow each of the other participating banks to carry with it at any point of time. A bank which received instructions that would bring the debit balance of the sending bank over the pre-established limit would have to

return those instructions to the sending bank for re-submission after the sending bank's balance had been re-established. If the network functioned through a central switch, the switch could be programmed to return the instructions to the sending bank rather than requiring the receiving bank to do so.

4. Net-net settlement

5. If a funds transfer network settles the day's funds transfers on a net-net basis, i.e. by establishing a single debit or credit balance for each participating bank for the total amount of all funds transfer instructions it has sent to or received from all other participating banks, but distributes loss in case of failure by a bank to settle on the basis of the net debit or credit balance of that bank with each of the other participating banks, the system risk is that of a net settlement network. However, where the loss is considered to be that of the entire network to be shared among the participating banks, under several of the possible loss-sharing formulas the loss to be borne by the other banks can often be estimated only after the close of the settlement. Under some formulas a bank with a credit balance in its own bilateral transactions with the non-performing bank might nevertheless be called upon to share in the loss. This in turn could mean that banks which could easily have settled if the settlement had been completed under normal circumstances may not be able to settle because of the loss they have suffered arising out of the failure of the first bank to settle. This cumulative effect arising out of one bank's failure to settle increases the system risk.

5. Means available to reduce system risk

6. A risk-reduction policy would have three principal goals: to limit the likelihood that a bank will fail to settle; to limit the effect of such a failure on other banks, the banking system as a whole and the economy in general; and to ensure the continued smooth operation of the funds transfer system. These goals may be in conflict. The primary techniques available for reducing system risk in either net or net-net settlement networks can be grouped under five headings:

(a) Participation in net or net-net settlement networks can be limited in various ways. The number of banks can be limited, since the fewer the number, the less likely that any one of them will fail to settle. The participating banks can be limited to those whose financial security is unquestionable. Foreign banks, which may be unable to settle in local currency, may not be permitted to participate, allowed to participate to only a limited degree or allowed to participate only if they furnish additional assurance of their ability to meet their commitments.

(b) The degree of monetary exposure of any single bank or of the network as a whole can be limited. Intra-day bilateral net debit limits can be established between individual pairs of banks. Intra-day net credit caps can be established limiting the amount owed by any one bank to the entire network. If more than one paper-based or electronic network exists in a country, the intra-day credit cap could be applied to the net amount owed by any one bank across all networks.

(c) The period of time from the sending of the first funds transfer instruction through the network until settlement can be reduced to a minimum so as to limit the possibility that events prior to settlement will cause a failure to settle.

(d) Banks can refuse to make funds available to their credit party until settlement has been completed. This protects the receiving bank in case of failure of settlement at the cost of

delaying availability of funds to the credit party. Since the credit party may need those funds in order to make its own funds transfers that day, as may be particularly the case where the credit party is itself a bank, the entire network may come to a halt because of a shortage of funds until those funds are made available subsequent to settlement. Alternatively, receiving banks may make the funds available to the credit party with a right to reverse the credit in case of failure of settlement. This protects the receiving bank to the extent the credit party is credit-worthy by shifting the risk of loss from the receiving bank to the credit party.

(c) The debit balance of each participating bank can be guaranteed by an appropriate financial institution, which might be the central bank or a private or public insurance fund. Protection of the system is most effective if the guaranteeing financial institution can make the necessary funds available immediately. Otherwise the system will suffer a cash-flow shortage that may cause other banks to be unable to meet their commitments.

B. National experience

7. In this section are set forth the experience of three countries which have taken different approaches to limiting system risk in their high-value electronic funds transfer networks.

1. France

8. On 16 October 1984 a high-value computer-to-computer network entitled *Système automatique de gestion intégrée par télétransmission de transactions avec imputation de règlements "Etranger"* (SAGITTAIRE) began operations. Since SAGITTAIRE was originally conceived as a domestic extension of S.W.I.F.T., only banks which are members or users of S.W.I.F.T. can participate in SAGITTAIRE. However, the use of SAGITTAIRE has been extended so that it can furnish the domestic link for essentially every type of international funds transfer labelled in French francs. It is not currently available for use for purely domestic funds transfers, although it has been decided that it will be available for payments arising out of money market transactions.

9. Although SAGITTAIRE functions as though it was a correspondent bank service of the Bank of France, the Bank serves only as the operating agent for the group of participating banks. Participating banks send SAGITTAIRE funds transfer instructions to the Bank of France with one of three entry dates, i.e. that day, the next banking day or two banking days later. The sending bank's "pseudo-account" is immediately debited according to the appropriate entry date, the receiving bank's "pseudo-account" is credited according to the appropriate entry date, and the funds transfer instruction is forwarded to the receiving bank.

10. The entry date closes at 12:00 on each full banking day (10:00 on partial banking days), i.e. an entry date of Wednesday, 4 March runs from 12:00 Tuesday, 3 March to 12:00 Wednesday, 4 March.

11. At the end of the banking day, i.e. at 17:30 on full banking days, the debits and credits arising out of SAGITTAIRE operations showing in the "pseudo-account" for that entry date are entered to the account of each participating bank with the Bank of France, along with the debits and credits to the account of the bank arising out of other banking operations. However, since the Bank of France does not allow a bank to carry a debit balance in its account,

the entries are not made if doing so would leave a debit balance in the account of a bank. If the debit balance is not covered by 11:30 the next morning, the Bank of France is authorized to annul the debit entries arising out of SAGITTAIRE transactions, as well as the corresponding credits, in the reverse order of reception of the instructions until the debit balance is eliminated.

12. As a result, if there was any reason to doubt the financial position of a sending bank, the most dangerous funds transfer instructions from the viewpoint of the receiving bank would be those which pass through SAGITTAIRE immediately before 12:00, while the most secure would be those made with a delayed entry date or which pass immediately after 12:00. However, since all participating banks are under public control, failure to settle is highly unlikely. The SAGITTAIRE rules do not specify when the receiving bank must credit its credit party. However, under standard French doctrine, the credit becomes irrevocable when the receiving bank enters a credit to the credit party's account (and not to his "pseudo-account"), even if the bank never receives value for the funds transfer.

2. United Kingdom

13. The Clearing House Automated Payment System (CHAPS) is a high-value same-day credit transfer network linking the twelve settlement banks, including the Bank of England. It is a nationwide supplement to, and eventually a replacement of, the Town Clearing, which is the specialized paper-based high-value funds transfer network limited to the City of London. A recent decision has been made that settlement membership in CHAPS and the Town Clearing, as well as in the other clearing arrangements, should be opened to banks which meet the following five criteria:

- (a) Readiness and ability to comply with the technical operational requirements of the clearings and agreement to be bound by the rules of the individual clearing company concerned;
- (b) Ability to establish settlement account facilities at the Bank of England;
- (c) Willingness to meet a fair share of operating costs;
- (d) Willingness to pay a fair entry price; and
- (e) Ability to meet a minimum volume criterion in the operational clearings concerned.

A number of banks, including the London operations of foreign banks, are seeking settlement membership in CHAPS and the Town Clearing. Non-settlement banks can have funds transfer instructions sent through CHAPS only by maintaining a correspondent bank relationship with a settlement bank.

14. Banks receiving credit transfer instructions through CHAPS are required to make same-day availability of the funds to the credit party. This rule is intended to increase the usefulness of CHAPS to the business and financial communities. In turn, the sending settlement bank is obligated to reimburse the receiving settlement bank for the amount of the funds transferred, even if the sending bank is not reimbursed by its instructing party. A funds transfer through CHAPS is unconditional and irrevocable.

15. The proper functioning of CHAPS, therefore, depends upon confidence in the solvency of the sending bank. This confidence has been secured in the past by restricting the number of participating banks in CHAPS and by relying on

the Bank of England to put through the final inter-bank CHAPS settlement transactions. At present settlement is made at the end of the day on a net-net basis by transferring balances of the settlement banks in their accounts with the Bank of England. In the new arrangement, "the prudential criteria to be met for settlement membership in any clearing [including CHAPS] should be subsumed into a precondition that members maintain an account with the Bank of England which could, with the Bank's express agreement, be used for the purposes of settlement in that clearing."¹

3. United States

16. Four large-value on-line credit transfer networks are currently operating in the United States. They divide conveniently into two groups. The first group is composed of Fedwire, operated by the Federal Reserve System. Fedwire permits all 14,000 banks in the United States and the other deposit-taking institutions which maintain account balances with their regional Federal Reserve Bank to transfer those balances to other banks or deposit-taking institutions. In effect, Fedwire functions as a correspondent banking service to the entire banking system.

17. The second group of on-line credit transfer networks is composed of the three private networks. CHIPS is owned and operated by the New York Clearing House Association. There are over one hundred participating banks authorized to submit credit transfer instructions for payment to other participating banks, of which a number are New York branches of foreign banks. The Clearing House Electronic Settlement System (CHES) is owned and operated by the Chicago Clearing House Association. Six large banks participate. CashWire is a part of BankWire, a nation-wide telecommunications network owned by a consortium of 180 United States banks, of which 17 use the settlement feature of CashWire. In addition, large-value transfers are made through correspondent banking relations, which are highly developed in the United States for use in domestic as well as international transactions.

(a) Fedwire

18. The rules governing Fedwire provide that a credit transfer is final between the sending bank and the receiving bank and the receiving bank has available funds when the receiving bank's regional Federal Reserve Bank sends the notice of the credit to it. The notice of the credit is sent by telecommunications to banks which are on-line with Fedwire and the notice may be given by telephone, telex or sent by mail to a bank which is not on-line. The Fedwire rules require the receiving bank to credit its credit party promptly after receipt of the notice, but the rules neither define how soon the credit must be given in order to be prompt nor do they purport to govern the time at which the transfer is final as to the credit party.

19. As a result of the credit transfer instructions which a bank sends over Fedwire and the other actions it may take affecting its account, the bank may run an intra-day or end-of-day debit balance at its regional Federal Reserve Bank. In particular, many banks borrow overnight from other banks in the inter-bank funds market and return those funds to the lending bank the next morning. The borrowing banks, which tend to be the large money-centre banks, often run large intra-day debit balances in their accounts with their Federal Reserve Bank that are restored to credit balance by the end of the day. As is true of any correspondent bank, the Federal

Reserve Bank may refuse to accept credit transfer instructions from a bank in debit balance until either it has received sufficient funds to restore a credit balance in the account or it is otherwise secured. However, if a debit balance does result, the Federal Reserve Bank carries the entire risk of non-reimbursement. Therefore, in addition to protecting the receiving bank, the Fedwire rules isolate the entire banking and non-banking sector from the immediate consequences of a sending bank's failure to settle.

20. The result of the Fedwire rule would be the same in regard to any correspondent bank governed by a similar finality rule, i.e. the correspondent bank would bear the risk if it irrevocably honoured a credit transfer instruction and the sending bank thereby incurred a debit balance in its account with the correspondent bank. However, if a sending bank fails to reimburse a privately owned correspondent bank, there is the risk that the correspondent bank may also fail, with potentially cascading effect throughout the banking system. This risk is not present in Fedwire since the correspondent bank is the central bank.

(b) Private networks

(i) Private network settlement rules

21. All three networks settle by reporting the net-net debit and credit balances for all transactions of their participants to their regional Federal Reserve Bank. Those banks with a debit balance transfer funds to a special clearing account for that network, usually by a Fedwire transfer from their account with the Federal Reserve Bank. Once all the banks in a debit position have transferred the funds due, the Federal Reserve Bank transfers the appropriate amounts by Fedwire to the accounts of those banks with a credit balance. The special clearing account carries no debit or credit balance forward after settlement is completed. One of the requirements of the Federal Reserve Banks in establishing the settlement arrangements with the three networks was that the Reserve Banks would bear no settlement risk arising out of the existence of the clearing accounts.

22. Participants in CHIPS are divided into settling and non-settling banks. Non-settling banks must settle any net debit balance with one of the settling banks and receive any net credit settlement through that bank. Settling banks settle through the clearing at the Federal Reserve Bank for the net debit or credit balance arising out of their own funds transfers and those of all the non-settling banks for which they settle.

23. The CHES rules are similar to those for CHIPS in that they permit a participant to settle through another settling bank rather than through its account with the Federal Reserve Bank.

(ii) Failure to settle

24. If any bank fails to settle its debit balance from CHIPS or CHES transfers at the end of the day, all transactions to that bank and from it are withdrawn from the settlement and new balances are calculated for the remaining banks. Since other banks may be unable to settle for their new debit balance, the ultimate procedure under the rules is for a general unwinding of the settlement. In that case, settlement for the day's transactions would have to be arranged by the participating banks on a bilateral basis outside the ambit of the current rules. CHES defines its unwind procedures as administrative aids to assist surviving institutions with claims.

25. Although settlement in CashWire is normally carried out on the basis of each bank's net-net debit or credit balance for its entire day's transactions through CashWire, in case any

¹ *Payment Clearing Systems. Review of Organization, Membership and Control* (London: Members of the Bankers' Clearing House, 1984), appendix I, p. 20.

bank fails to settle, the rest of the settlement is carried out by pairs of banks on a net settlement basis. Therefore, each bank carries the risk that it will not receive reimbursement for the net amount of credit transfer instructions it has received from another bank through CashWire that day in excess of the credit transfer instructions it has sent to that bank.

(iii) *Private network finality rules*

26. CHIPS transfers are final when released to the receiving bank in that the sending bank may not withdraw the credit transfer instruction. However, since there is a possibility that receiving banks will not receive settlement for transfers through CHIPS, they are not obligated to honour funds transfer instructions or to give irrevocable credit to transferees or other credit parties until settlement is final.

27. CHES and CashWire transfers are final as to both sending and receiving banks when received by the latter. The sending bank may not withdraw the credit transfer instruction.

(c) *Methods considered to reduce system risk*

28. The American banking community has been concerned with limiting the systemic risk arising out of the recent increase in bank failures. In respect of the possibility of a failure to settle, on 29 March 1984 the Board of Governors of the Federal Reserve System requested comments on various proposals to reduce system risk in high-value funds transfer networks. Over two hundred comments were received. The principal methods to reduce system risk suggested by the Federal Reserve or by respondents are set out in the following paragraphs.

(i) *Bilateral net credit limits*

29. Under this method each bank would determine the maximum amount of the net intra-day credit it is willing to extend to any other bank arising out of funds transfers through the network. Such a limit would be flexible, with each bank adjusting the net credit limit it would extend to other banks depending on considerations relating to the economy in general, to perceptions of the other bank's current financial position or to meet immediate business needs. Since a bank which carried a reasonable balance with each of a large number of other banks might have a combined debit balance beyond its means, this method might have little likelihood of reducing the risk of a bank failing to settle. However, by limiting the effect of a failure to settle on any other particular bank, this bilateral net credit limit may reduce the risk to the system.

30. Each of the three private large-value networks has a requirement that the participating banks have bilateral net credit limits for each of the other participating banks for funds transfers made through that network. These limits are monitored on a real-time basis by the network computers. If an individual bank wishes to have a bilateral credit limit for another bank applicable across all systems, it has to monitor the situation itself.

31. Bilateral net credit limits are not applicable as such to Fedwire or private correspondent banking relationships. However, the same result is achieved by limits on the intra-day debit balance any bank is permitted to carry with the Federal Reserve Bank or with the private correspondent bank.

(ii) *Sender net-debit cap*

32. A sender net debit cap limits the extent to which a bank can send credit transfer instructions to all other banks beyond the amount it receives from them. Sender net-debit

caps of 50 per cent of capital are currently in effect in CashWire. CHIPS is actively considering caps based on a percentage of the total bilateral credit limits established for a bank by all other participating banks individually.

33. By restricting the extent to which a bank can send credit transfer instructions beyond the amount received and applying the restriction continuously throughout the day, the likelihood that the bank will fail to settle as well as the consequences of such a failure, is reduced. However, if sender net-debit caps are applied separately to each of the three private networks, it has been thought that the total net amount a bank could send might be too high. An alternative, therefore, would be a single sender net-debit cap applicable to all networks combined.

34. While the usefulness of sender net-debit caps to reduce risk seems clear, it is feared that one adverse effect could be to interfere with the funds transfer system. A bank which had not yet received sufficient funds transfers from other banks might find itself unable to effect the funds transfer requests of its customers. In particular, banks which had borrowed funds overnight might find that they had reached their net-debit cap simply by returning the borrowed funds the next morning. In order to reduce the possibility of this happening to them, banks might delay sending funds transfer instructions to other banks until late in the day, thereby generally slowing the entire funds transfer system and threatening traffic jams at the end of the day.

(iii) *Guaranteed finality of honour by receiving bank*

35. Finality of honour to the transferee is assured once the inter-bank transfer through correspondent banks (either two-bank funds transfers or three-bank funds transfers as in Fedwire) is completed since the transferee bank automatically has value. Finality of honour to the transferee is assured in a net settlement network if the receiving bank is obligated to credit its credit party whether or not it receives settlement, as is currently the rule in CashWire and CHES.

36. Guaranteed finality of honour by the receiving bank insulates the non-banking sector of the economy from the effect of a failure to settle, thus protecting financial markets and the general economy. It could be expected that receiving banks would automatically limit their exposure to sending banks which they considered doubtful by lowering the bilateral net credit limit they had established. On the other hand it has been suggested that guaranteed finality might cause receiving banks to increase fees to compensate themselves for bearing the increased risk and would lead to a reduction in the willingness of banks to receive funds transfers.

(iv) *Central bank guarantee of debit positions*

37. One means of reducing system risk which has been carefully avoided to date is for the Federal Reserve and other banking authorities to guarantee the obligations of participants in the system beyond that already available for small deposits. The recent closing of a number of small and medium-sized banks and the rescue of a large bank by the banking authorities have caused those authorities to search for other means to reduce system risk.

(v) *Insurance to guarantee debit balances*

38. The guarantee of the debit balances arising in settlement networks could also be covered by a public or private insurance fund, similar to the insurance funds covering small deposits in banks and other deposit-taking institutions. One estimate which has been made is that the premium cost would approximate \$1.90 per million dollars in funds transfers.

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Chapter on legal issues raised by electronic funds transfers

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INTRODUCTION

1. The previous chapters in this Legal Guide have described the relationship between developments in electronic funds transfers and the paper-based funds transfer system in the context of the legal régime governing funds transfers. In this chapter a number of legal issues arising out of these developments are set forth as questions to be considered in the preparation of new rules necessitated by the introduction of electronic funds transfers. Most of these issues raise specific questions as to the appropriate legal rule and are based on the discussion in the previous chapters. Several of the issues raise questions of general policy. Following each question is a short comment indicating several factors which may influence the decision to be made in respect of the question posed.

2. The comments contain references to those portions of the previous chapters that are particularly relevant to the question posed as well as to certain material outside the Legal Guide. The references to the chapters have been abbreviated as follows:

"Terminology" (A/CN.9/250/Add.1)	"Terminology"
"Electronic funds transfer system in general" (A/CN.9/250/Add.2)	"EFT in general"
"Agreements to transfer funds and funds transfer instructions" (A/CN.9/250/Add.3)	"Agreements"
"Fraud, errors, improper handling of transfer instruction and related liability" (A/CN.9/250/Add.4)	"Liability"
"Finality of funds transfers" (A/CN.9/266/Add.1)	"Finality"

Issue 1

Are major changes in the law required by the development of electronic funds transfers?

Comment

1. Since the underlying funds transfer procedures remain the same whether the medium of communication is paper-based or electronic, it could be expected that the law governing paper-based funds transfers would remain fundamentally appropriate for electronic funds transfers.

However, since electronic funds transfers are not carried out in a manner identical to paper-based funds transfers, changes in the law to adjust to the new procedures should be expected. The following paragraphs suggest some of the major elements that would affect the extent to which the law written for paper-based funds transfers might need to be adapted to make it appropriate for electronic funds transfers.

2. Since most electronic funds transfers are made by credit transfer, countries where funds transfers have been largely made by cheque may have few legal rules which are directly applicable. Although this Legal Guide has frequently pointed out the identity or comparability of the rules governing debit transfers and credit transfers, rules drafted for the issue, collection and payment of cheques, with their elements of negotiability, are not applicable to credit transfers without significant modification.

3. The elimination of all elements of negotiability from electronic debit transfers, except for those transfers involving the truncation of cheques, bills of exchange or other negotiable debit transfer instructions, presents the opportunity for unifying or harmonizing the law of debit transfers with the law of credit transfers. Some degree of harmonization may already be present in the rules governing electronic funds transfer networks handling both types of funds transfers. A more substantial opportunity for harmonizing the law may be present when the statutory law governing funds transfers is reviewed for its applicability to electronic funds transfers.

4. Even in countries with a satisfactory legal structure for paper-based credit transfers, the new technology requires an adjustment of the law in regard to such matters as the periods of time within which various actions are to be taken, the presence or absence of liability arising out of computer failure at one of the banks, clearing-houses or communication networks, the time when a funds transfer becomes final and the consequences of finality. Modifications of this nature to the existing legal rules do not affect their structure, but they may modify their content to an important degree.

5. Although the absence of negotiability in electronic funds transfers presents the opportunity to simplify the law by harmonizing the law of debit transfers and credit transfers, the technical development of several alternative ways of making funds transfers, and the continual change in the technology, may lead to new subdivisions

in the law. It may be useful to distinguish between batch-processed funds transfers and individual funds transfers sent by telecommunications, between transactions using debit cards and those using credit cards, between those initiated on customer-activated terminals and those where the electronic communication is initiated at a bank. To some extent these distinctions may be satisfactorily expressed in bank-customer contracts and in inter-bank rules governing different types of funds transfer networks. However, in some cases these distinctions may need to be expressed in the statutory law governing funds transfers. If the number of special rules which are the result of these distinctions is small, they can be handled within the general law of funds transfers. If the number of special rules is too large, it may be preferable for special laws to be adopted, as there currently are for debit transfers and credit transfers. In any case, there will continue to be a need for rules governing paper-based funds transfers, and in particular to cover cheques and bills of exchange.

6. Some questions arising in the context of electronic funds transfers are common to all forms of automatic data processing and the legal rules may also be common to all such transactions. Prominent among these questions is the evidential value of the computer records of funds transfer instructions sent and received in computer-readable form and of account records stored in that manner. Of particular concern is the acceptability of the authentication used in electronic funds transfers. In some cases, the rules in respect of these matters may be found in the law governing funds transfers rather than in laws of general application.

7. The concurrent growth of electronic funds transfers and of international large-value and small-value funds transfers is leading to the international standardization of funds transfers procedures and a growing interest in the international unification and harmonization of the governing law. This Legal Guide is one important step in that direction. A further step would be the preparation of rules governing aspects of international funds transfers in some appropriate manner. Yet a further step would lead to the unification or harmonization of some aspects of domestic law, especially in respect of those aspects of funds transfers which are the domestic extension of an international funds transfer.

Issue 2

To what types of financial transactions should the law of funds transfers apply?

References

- "Finality" paras. 44-47
- Issue 4, para. 5

Comment

1. In a number of countries, deposit-taking institutions which previously were not permitted to make funds

transfers on behalf of their customers are now permitted to do so. However, in some countries the law of funds transfers has been applied only to transfers made by debit and credit to current accounts in a bank, as the term "bank" is narrowly defined by the relevant law. Funds transfers made by debit to a current account in other types of deposit-taking institutions, including funds transfers made by debit to accounts with the postal system, have often been governed by a distinct set of rules, even though the rules were often the same or similar in substantive content to the rules governing funds transfers made through banks. There would be no technical difficulties for funds transfers made through the efforts of all deposit-taking institutions to be governed by the same set of legal rules, if this was considered desirable.

2. In addition to accounts at deposit-taking institutions, customers may hold credit balances at many other types of financial institutions, such as stock or commodity brokers or insurance companies. In some countries it has become possible for customers to transfer those credit balances in whole or in part to accounts of other parties held with the same institution, at a different institution of the same type or at a bank. This developing practice raises important monetary and regulatory questions in regard to the banking and funds transfer systems in general. It also raises the question as to whether these transfers of account balances, if they are permitted at all, should be governed by the law of funds transfers or whether a different legal régime should be applied. If a different legal régime is applied, many of the same or similar legal problems as those covered by the law of funds transfers will need to be considered.

3. A credit card transaction may be considered not to be a funds transfer for the purpose of applying the relevant law of funds transfers, e.g. consequences of a fraudulent transaction or finality of the debit, since the debit is usually considered to be an extension of credit to which certain rules of consumer credit may apply and which must subsequently be reimbursed by a credit from another account of the customer. The law of funds transfers may be considered to apply only to the customer's reimbursement of the debit and, perhaps, to the reimbursement of the merchant or other card acceptor.

4. Nevertheless, when the account is held with a bank or other deposit-taking institution, it may be considered appropriate to include such transactions within the category of funds transfers, particularly since debit card transactions on accounts held by banks would clearly fall within the category of funds transfers. If credit card transactions on accounts held with banks are considered to be funds transfers, the question arises whether credit card transactions leading to a debit to an account held with an institution which is neither a bank nor other type of deposit-taking institution should also be subject to the law of funds transfers. The decision may be affected by whether the credit card paper or electronic vouchers (debit transfer instructions) clear through or outside banking channels. This basis for a decision,

however, might be upset by subsequent changes in clearing procedures.

5. A somewhat similar problem may be posed by the use of a microcircuit card which has been charged with value by the bank before its issue to the customer. The issue of the charged card to the customer and the debit to his account may be considered to be a completed funds transfer equivalent to the sale of traveller cheques. Use of the card would set in motion a procedure for reimbursement of the merchant by the bank which might be considered to be a form of electronic debit transfer similar to the collection of the traveller cheque. However, if the charged card were considered to be a special form of account with the bank, the issue of the charged card to the customer would merely furnish the customer with a means of accessing that account. Nevertheless, the consequences to the bank and the customer arising out of the issue of the charged card to the customer might be appropriately covered in the law of funds transfers in the same way that the consequences to the bank and customer arising out of the issue of cheques, debit cards or other devices to access the account is also covered in the law of funds transfers.

Issue 3

Should the law governing funds transfers recognize the increased role of the funds transfer system in individual inter-bank funds transfers?

References

- "Terminology", paras. 1-7
- "EFT in general", paras. 1-5
- "Liability", paras. 56-60
- Issues 13, 16, 18, 22, 23

Comment

1. Until recently in most countries the funds transfer system in place did not restrict significantly the judgement of banks as to the methods by which funds transfers were made. The smaller volume of funds transfers allowed each funds transfer instruction to be considered as an individual item calling for the specific judgement of each bank in the chain as to how it should be handled.
2. Recent technological developments have led to the creation of specialized communications and funds transfer networks and a consequent standardization of many aspects of funds transfer procedures. Funds transfers are processed through these networks in large quantities and the design of the total funds transfer system determines whether funds transfers can be made promptly, accurately and safely.

3. Among the factors influencing the extent to which the increased role of the system might be consciously taken into consideration in the law governing funds transfers is the extent of fragmentation of the banking

system. Where there are only a few banks with many branches, each bank represents a major portion of the funds transfer system as a whole. The bank would necessarily be responsible for the design of both the computer facilities at a specific branch and for the transmission system between branches. Since it would often be both transferor bank and transferee bank, most of the legal problems arising out of the transmission of funds transfer instructions from one bank to another would be eliminated. Therefore, there may be no significant distinction between rules based upon the bank as an individual entity and the bank as a participant in the larger framework of the funds transfer system.

4. Where the banking system is fragmented and there are a large number of banks engaging in funds transfers, the distinction between the bank as an individual entity and the bank as a participant in the funds transfer system is naturally greater. This fact may lead in two different directions. On the one hand it may be more important for the law to recognize overtly that the bank is operating in the context of the funds transfer system. On the other hand there may be more resistance on the part of the banks to losing whatever degree of independence may be involved in such a recognition.

5. The fragmentation of the banking system is of particular importance in respect of international funds transfers. Not only do many banks from all countries participate in making funds transfers, but the different banking practices and different legal rules have tended to isolate the banks from one another. However, it may be thought that it is precisely in the field of international funds transfers that the practices of individual banks are changing most significantly in order to conform to the technological requirements of particular funds transfer networks and of the funds transfer system as a whole.

6. The important role the system plays in funds transfers may be recognized in the law in many ways. Inter-bank agreements, including clearing-house rules, may be accepted as a principal means of providing rules for the system. Those rules, or the law itself, may fix a single party responsible to the customer for errors or fraud which occur at any place in the system. Banks may be required to apply standardized procedures in order to participate in certain funds transfer networks. If they suffer loss as a result of failure of design of the system or of its implementation, they may have a right of reimbursement from the system as a whole or from other participant banks.

Issue 4

Should funds transfers between the transferor and transferee and the funds transfer transactions implementing the funds transfer be governed by the same rules? If some of the rules might be different, should the differences be reflected in the law or by inter-bank agreements?

References

- "Finality", paras. 23-30
Issues 2, paras. 3-4, and 5

Comment

1. Funds transfer transactions between banks implementing an inter-bank funds transfer between a transferor and transferee can be viewed in two ways. The traditional view in most countries is that the funds transfer transactions are subsidiary to the funds transfer. Inter-bank agreements in respect of funds transfers serve primarily to govern the technical relations between the banks and do not, or should not, affect the legal rights of the transferor and transferee. A second point of view, seen most clearly in regard to credit transfers transmitted individually by telecommunications, is that the primary activity taking place is the funds transfer transaction between the sending and receiving banks. Credit transfers between banks serve a number of purposes, only one of which is to implement a customer's instruction. The fact that a particular funds transfer transaction was made pursuant to a customer's instruction would be of operational interest to the transferor bank, since it would have to debit the appropriate customer account. However, it would be of no operational interest to intermediary banks except to the extent that a particular message type would be used and certain data fields in the funds transfer instruction would contain information to be passed on to the next bank.

2. Since each funds transfer transaction is treated by the banks as a separate and complete banking transaction, it could be expected that legal problems, such as the time of finality of the transaction or liability for errors, would arise just as they do in respect of the funds transfer itself. In the absence of any other rules, it could be expected that the rules otherwise applicable to funds transfers would apply. It may be thought, however, that appropriate rules for a funds transfer transaction between two banks might be somewhat different from appropriate rules for a funds transfer between two non-bank customers, even if the funds transfer transaction is implementing a customer transfer.

3. If it was desired to have rules for funds transfer transactions that were somewhat different from those governing funds transfers between bank customers, consideration might be given as to whether it would be preferable for those rules to be part of the general law of funds transfers, to be in a special section of the law governing inter-bank relations, or to be the subject of inter-bank agreements. In favour of the rules being adopted in the form of law is that, since the rules governing funds transfer transactions could be expected to have an effect upon the customer transfer, they should be prepared in such a way as not to interfere with the customer's legal rights. Therefore, it would be preferable if they were subjected to the public review normally available to proposed laws. In favour of the rules being adopted by inter-bank agreement is that different rules might be appropriate for different funds

transfer networks. Furthermore, the technical nature of many of the rules and the need to amend them as the relevant technology and banking practices evolve, might make it better for them to be in a more flexible form. It might be thought that any effect they would have on bank customers would be no more significant than the current rules or banking practices governing the technical aspects of the funds transfer transaction.

4. Special attention might be given to the desirability for agreed rules governing aspects of international large-value funds transfer transactions. Since the domestic rules governing inter-bank transfers, which might otherwise apply in large measure to international transfers as well, differ in important respects from one another, unification or harmonization of these rules to the extent possible might be expected to have important beneficial results.

5. The situation would seem to be somewhat different in respect of international credit card and debit card transactions. Before cards issued in one country are accepted in a second country, inter-bank agreements are always concluded governing both technical and legal concerns. These agreements are specific to each network. Therefore, several inter-bank agreements governing the international use of credit cards and debit cards are already in force in most countries. Since credit card and debit card funds transfer instructions are currently cleared through special channels for technical reasons, there is little conflict with other forms of international funds transfers. However, if this form of international funds transfer continues to grow in volume, consideration might be given to its relationship to the legal régime governing other forms of international funds transfers.

Issue 5

Should internationally agreed rules be prepared to govern international electronic funds transfers?

References

- Draft Convention on International Bills of Exchange and International Promissory Notes (A/CN.9/211)
Issues 4 and 6

Comment

1. Once the transferor instructs his bank to transfer funds to the transferee at a bank in a foreign country, an international funds transfer has begun. As a result there is a high degree of inter-mixture of domestic and international concerns in an international funds transfer. The funds transfer itself between transferor and transferee is international. The very first and last actions, the issue of the funds transfer instruction by the transferor, the debit of his account by the transferor bank and the credit to the account of the transferee, are in themselves domestic acts identical to those made in a domestic funds transfer. One or more funds transfer transactions are required between banks in different countries as well as the possibility of one or more of funds transfer transactions in the country of the transferor and in the country of the transferee.

2. The situation has some similarity to the shipment of goods from an inland point in one country to an inland point in another country in that the single economic activity of the shipper may be carried out by domestic carriers in the two countries as well as by one or more international carriers. There is a tension between the need or desire for separate legal régimes to govern each of the domestic and international segments of the shipment and the need or desire for a single legal régime to govern the entire shipment. In the context of the shipment of goods, the desire for a single legal régime to cover the entire shipment has led to the adoption of the United Nations Convention on International Multimodal Transport of Goods. This Convention does not, however, replace the legal régimes governing the individual segments so much as it co-ordinates some of their legal effects.

3. Since there are at present no rules governing international funds transfers, with the exception of the S.W.I.F.T. rules covering aspects of the transmission of a funds transfer instruction over that network and the network rules for credit cards and debit cards used internationally, the consequence of a funds transfer being international or of one or more of the implementing funds transfer transactions being international, is that the rules of conflict of laws would refer to the substantive law of one of the countries concerned. That law may or may not have special rules governing international funds transfers or, without having specially articulated rules, may recognize the differences inherent in an international funds transfer. Among those important differences is that some part of the funds transfer is carried out in a foreign country in conformity with the local banking laws and practice.

4. The basic approach followed in the draft Convention on International Bills of Exchange and International Promissory Notes, prepared by the United Nations Commission on International Trade Law, has been that the draft Convention should govern the funds transfer instruction issued by the transferor and all of the funds transfer transactions necessary to implement that instruction. However, it may be noted that the draft Convention specifies that certain legal problems concerning the bill are not governed by it. Of particular interest is the fact that the rights and obligations of an intermediary bank that becomes an endorser of the bill would be governed by the Convention, even if the bill of exchange were to come to it from another bank in its own country. This is consistent with the traditional view noted in Issue No. 4 that the inter-bank transactions implementing a non-bank customer's funds transfer instruction are subsidiary to the funds transfer. In the context of electronic funds transfers, the same approach would subject the funds transfer transaction between the domestic transferor bank and domestic intermediary bank to the international rules. This would be of particular significance to domestic electronic funds transfer networks which handle the domestic link in international funds transfers.

5. The potential impact of the draft Convention is limited by its article 1 on the scope of application, which provides that the draft Convention applies only if

the parties have chosen it as the governing law by use of a bill of exchange which contains the words "international bill of exchange (Convention of . . .)". It would not, therefore, apply to all bills of exchange used in international transactions between parties in contracting States. A similar restriction could be introduced into rules governing international electronic funds transfers, in which case the funds transfer instruction sent by the transferor bank and by every intermediary bank would have to contain that information.

6. A less radical approach than that taken in the draft Convention would be that the relations between, on the one hand, the transferor and transferee and, on the other hand, all banks in the funds transfer chain would be governed by the internationally agreed rules, but that the inter-bank funds transfer transactions would be governed by the relevant domestic law, supplemented by any applicable inter-bank agreements. If this approach was taken, a decision would have to be made as to which text controlled where the international rules gave the transferor or transferee rights as against one of the banks but the relevant law or inter-bank agreement had conflicting provisions in respect of an implementing funds transfer transaction. For example, the international rules might give a right to withdraw a funds transfer instruction until the transferee's account had been irrevocably credited, but the rules governing a funds transfer network through which the funds transfer passed might limit the extent to which a funds transfer instruction could be withdrawn by a sending bank (see issue 33).

Issue 6

Should internationally agreed rules on conflict of laws be prepared for international electronic funds transfers?

Reference

Issue 5

Comment

1. In the absence of a generally accepted legal régime governing international electronic funds transfers, internationally accepted rules on conflict of laws might be considered.

2. The aspect of the law of funds transfers which might most benefit from internationally agreed rules of law is the relationship of the transferor and transferee between themselves and their relationship to the banks implementing the funds transfer. The difficulties may be particularly acute when the funds transfer is in the currency of a third country and banks in that country become involved either as intermediary banks or as reimbursement banks. The most evident substantive difficulty which could be ameliorated by internationally agreed rules on conflict of laws is the lack of agreement whether an intermediary bank owes any duties directly to the transferor (perhaps as the transferor's agent as nominated by the sending bank) or whether the

intermediary bank's obligations are limited to the sending bank with which it is in privity of contract. Although this issue may arise most often in regard to liability for errors or delay, it may also arise in connection with such matters as whether the transferor or transferor bank could directly instruct an intermediary bank with which it was not in privity of contract to refrain from processing further a funds transfer instruction that the intermediary bank had received from another intermediary bank.

3. The conflict of laws problems in regard to the funds transfer transactions are perhaps easier to resolve, since each funds transfer transaction is a simple bilateral arrangement. Only the electronic funds transfer instruction which is sent from one country to another would probably be in question, while the domestic funds transfer transactions before and following the international transaction would presumably be governed by domestic law.

4. If rules on conflict of laws were to be prepared, it would seem that they could not be done effectively by the banking community. The courts could be expected to enforce inter-bank agreements containing substantive rules governing the relationship between the banks as well as a choice-of-law clause governing the bilateral relationship of the two banks in a funds transfer transaction. However, it is less likely that they would enforce choice-of-law provisions in an inter-bank agreement prepared for adoption by the banking community as a whole that was intended to provide rules for all of the possible conflicts that might arise in the various funds transfer transactions. It is also unlikely that they would enforce rules on conflict of laws prepared by the banking community governing the relations of the transferor and transferee with the banks implementing the transfer.

5. Therefore, if it was felt desirable for internationally agreed rules on conflict of laws in regard to international electronic funds transfers to be adopted by States, it would seem best if they were prepared by an appropriate international body.

Issue 7

Do the rules of evidence give records of funds transfers kept in computer-readable form the same legal value as records kept in paper-based form?

References

Legal value of computer records: report of the Secretary-General (A/CN.9/265)

Issues 21, 22

Comment

1. Although the rules of evidence do not form a part of the law of electronic funds transfers, in order for domestic or international electronic funds transfers to be made with legal security, the rules of evidence must

give bank records kept in computer-readable form or produced from computer-based entries the same legal value as records kept or produced in paper-based form. Therefore, an important part of many national studies of the legal aspects of electronic funds transfers has been devoted to the question of evidence.

2. According to the results of a survey conducted by the secretariat of the United Nations Commission on International Trade Law, it appears that in most countries records kept in computers can be used as evidence in case of litigation. In common law countries, it is the usual rule that computer records can be admitted as evidence only if the proponent of the record establishes certain facts about the record and the computer system. The most important is that the system has been properly designed and sufficiently well-managed so that the possibility that the data stored in the record is incorrect is reduced to a minimum. In some common law countries, records of financial institutions are admitted with less formality. In countries with other legal systems, it is not necessary to establish that the system is properly designed and well-managed for a computer record to be admitted as evidence. However, in all legal systems, it is possible to challenge the accuracy of a computer record on the grounds, *inter alia*, that the computer system was not properly designed or well-managed.

3. In several countries with an exhaustive list of types of admissible evidence, computer records are admissible in commercial disputes but may not be admissible in non-commercial disputes. Since the latter category may include most transactions made through automated cash dispensers, automated teller machines and point-of-sale terminals, the potential problems for electronic funds transfers may be significant in those countries. In particular, when a non-commercial customer denies having used a customer-activated terminal, it may be difficult or impossible for a bank to prove that he did so on the basis of the computer record of the transaction alone (see issue 21). In a few countries with statutory requirements as to the supporting information to be furnished to a court to enable the court to determine whether a computer record should be admitted as evidence, the statutory requirements have been drafted in terms of data processing in batch-mode and there may be difficulties in using computer records in which a funds transfer instruction was created in one computer and transmitted to a second computer by handing over a computer memory device or by telecommunications.

4. There does not as yet appear to be any experience whether computer records created in one country will be usable as evidence in the courts of another country on the same conditions as computer records created in the second country. Any difficulties in this regard would be of serious concern for international electronic funds transfers.

5. Truncation of paper-based debit or credit transfer instructions and the forwarding of the essential data by electronic means may raise questions as to the evidential

value of the computer record in the truncating bank or in a receiving bank in comparison with the value of the paper-based instruction. Many countries may require a permanent hard copy of the original paper-based instructions, but may allow that hard copy to be retained in microfilm form.

Issue 8

Are changes in the law required in order to permit the truncation of cheques, bills of exchange and other debit transfer instructions at the bank of deposit?

References

"Agreements", paras. 13-18

Convention providing a Uniform Law for Bills of Exchange and Promissory Notes (Geneva, 7 June 1930)

Convention providing a Uniform Law for Cheques (Geneva, 19 March 1931)

Comment

1. It appears that in those countries in which banks truncate cheques or other debit transfer instructions they have done so without legislative changes in the governing law. The banks seem to have determined that the savings from truncation are greater than the anticipated losses they would on occasion suffer because they could not conform to the statutory requirements adopted before truncation was possible. In a number of other countries, it appears that concern over the potential losses arising out of truncating cheques without changes in the statutory requirements has been a significant factor in slowing this development. Therefore, in all countries in which cheque truncation is seriously being considered, thought should also be given to amending the law on cheques and bills of exchange to eliminate any losses to banks which might occur and which are not justified by public policy.

2. The most important risk which occurs as a result of cheque truncation is that the authenticity of the drawer's signature cannot be verified by the drawee bank before the cheque is honoured. That would not constitute a major change from the current situation in many countries where banks do not compare signatures on the vast majority of cheques. Furthermore, a drawer of large numbers of cheques may give the drawee bank a list on paper or on magnetic tape of the cheque numbers and amounts of all cheques drawn, permitting substantial verification by the drawee of the authenticity of the cheques which have been truncated. Therefore, it may seem reasonable for the drawee bank to continue to bear the risk that a truncated cheque might not be genuine. As an alternative, the statute might be changed to provide, for example, that the drawee bank could debit the drawer's account even though the drawer's signature was not genuine if the cheque was drawn on a numbered cheque furnished to the drawer by his bank and the drawer had not notified the bank that the numbered cheque was missing. This would in essence

reproduce the rule generally followed in respect of debit cards and credit cards.

3. In most countries where the law seems to provide that a cheque can be honoured only if it is physically presented to the drawee bank, the provisions can often be interpreted to mean that it is the data on the cheque which must be presented and not the physical cheque as a carrier of the data. Where this interpretation is not possible or is not acceptable, the law might be changed to so permit. This question may also arise in respect of whether the cheque has been presented within any applicable periods of time and the time allowable after dishonour for notice of dishonour or protest to be made.

4. In a few countries the drawee bank is obligated to verify that the cheque has not been presented before the date on the cheque and conversely that the cheque is not so old as to have lost its validity. These verifications can be performed as easily by the truncating bank and it would seem that the most reasonable action would be for banks to agree that any loss borne by the drawee bank in its relations with the drawer would be reimbursed by the truncating bank. Similarly, the truncating bank is in as good a position as the drawee bank to determine whether the cheque has been materially altered and to mark the cheque so that it cannot be presented a second time.

5. Where protest is required on a dishonoured cheque itself, it would seem reasonable to modify the law so that protest or its equivalent could be made in some other appropriate way. Similarly, where cancelled cheques must be returned to the drawer before time-limits begin to run within which the drawer can notify the bank of improper debits to his account, the law might be modified to eliminate this rule.

6. States which are parties to the Geneva Conventions on Bills of Exchange and on Cheques would be in violation of their treaty obligations if they were to modify their domestic laws so as to facilitate truncation.

Issue 9

Does the development of electronic funds transfer techniques require changes in the law governing bank secrecy?

References

Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data (Strasbourg, 28 January 1981).

Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (Organisation for Economic Co-operation and Development, Paris, 23 September 1980).

Comment

1. Bank secrecy is one of the more important aspects of the continuing public debate over invasions of

privacy that are facilitated by the storage of data in computers, the linking of the computers by telecommunications and the availability of remote access to them. An important additional concern is that data regarding banking transactions may reveal underlying patterns of economic activity. Therefore, some States wish to limit the transborder data flows by which this information is transmitted to other States for processing or for use.

2. In many countries banks have a professional obligation to keep secret the affairs of their customers, except to the extent that disclosure of information is authorized by the customer or is required by the State in accordance with the relevant provisions of law. Violation of their professional obligation may lead to criminal penalties or to liability to their customer for the resulting harm. In the past, an unauthorized disclosure was usually the deliberate act of the bank or of one of its employees. Now that unauthorized disclosure can result from access to the bank's computer by an unauthorized person or by the interception of teletransmitted funds transfer instructions, consideration may perhaps be given as to whether banks have a broader duty to establish a security system for the transmission of funds transfer instructions and their storage which limits the possibility of such access.

3. The ease of making international transfers of funds by telecommunications facilitates the hiding of funds transfers made for such reasons as payment for illegal transactions, the avoidance of taxes or the avoidance of exchange controls by shifting the funds rapidly through a series of accounts in different places. The public authorities in a number of countries have attempted to counter these activities by more thoroughly investigating bank records of funds transfers, including in some cases account records of banks or branches in foreign countries. In some instances requests for information in account records of foreign banks or branches directed either to the banks or to the foreign Governments have been resisted on the grounds of bank secrecy or on the grounds that to make the information available would be an act of economic espionage.

4. The arguments in favour of strengthening bank secrecy in the face of the additional threats posed by the use of computers, as well as the arguments in favour of increased access to bank records in criminal investigations and increased international co-operation in this regard, are of great current importance. The resolution of the debate over these and related issues may, however, be expected to occur in a broader forum than one devoted to electronic funds transfers, or even to banking in general.

Issue 10

Should banks have written contracts with their customers covering rights and duties of the customers and the banks in respect of electronic funds transfers?

Reference

"Agreements", paras. 1-11

Comment

1. Traditions vary in different countries as to the need for written contracts. In those countries where written contracts are not common, banking tradition and practice are usually called on to provide the content of the agreement between the parties.

2. It may be thought, however, that in respect of new funds transfer techniques, and especially electronic funds transfers, banking tradition and practice may not be able to provide the necessary content for many of the questions that may arise. It appears that banks always require written agreements before they issue credit cards or debit cards. Written contracts seem not to be always required before customers are allowed to participate in cash management programmes and other large-value funds transfers, although they may be particularly useful in this regard since some aspects of the bank-customer arrangement may differ from customer to customer.

3. Except for some aspects of the contracts negotiated for large-value funds transfers, bank-customer agreements are drafted by the banks and presented to their customers as a condition for opening an account. The techniques available for limiting the potential abuses of such contracts of adhesion differ in various countries.

Issue 11

Should there be any restrictions placed on standing authorizations to debit?

Reference

"Agreements", paras. 21-23

Comment

1. Although a standing authorization to debit is analytically the same as an authorization to a bank to honour designated bills of exchange drawn on the transferor and domiciled at the bank, there are functional differences which may raise concerns. The most important is that the collection of bills of exchange is used only to secure payment from a commercial party, whereas the most extensive use of standing authorizations to debit is to collect amounts due on a regular basis from consumers. A second important difference is that the authorization to honour a bill of exchange can be lodged only with the transferor bank, whereas in some countries a standing authorization to debit may also be lodged with the transferee bank or even with the transferee.

2. It may be thought that a standing authorization to debit should be lodged with the transferor bank since this would permit the transferor bank to verify the existence of the authorization before acting on the debit transfer instruction received from the transferee bank

or from the transferee (in a one-bank transfer). However, even if the standing authorization to debit is lodged with the transferor bank, there is no assurance that the debit transfer instruction prepared by the transferee properly reflects the obligation due on the underlying transaction. Therefore, it may be thought that in all cases the transferor should have an unqualified right for a specified period of time to require reversal of the debit if he claims that it was improper. Reversal of the debit would, of course, revive the transferor's obligation to pay the underlying obligation. Consideration might be given to exacting a penalty against a transferor who claims reversal of the debit when a valid authorization was in existence and the transferor had no substantial reason to believe the amount of the debit was incorrect.

3. The inter-bank agreements covering standing authorization to debit should provide a warranty on the part of the transferee bank that it will reimburse the transferor bank for any debits it has been required to reverse on the demand of the transferor. The transferee bank should have a similar warranty from the transferee.

4. Where the debit transfer is submitted at a frequent and regular interval for a constant amount, the transferor can easily plan his cash flow. When the transfer is irregular, infrequent or for a fluctuating amount, the transferor, especially a non-commercial transferor, may not be able to plan his cash flow properly. The significance of this concern depends in large part on the extent to which transferors, especially non-commercial transferors, are permitted to carry debit balances in their accounts at reasonable rates of interest. Where this concern is significant, consideration may be given to requiring the transferee, transferee bank or transferor bank to notify the transferor of the date and amount of the forthcoming debit in sufficient time for him to adjust his cash flow. Consideration may also be given to permitting the transferor to withdraw his authorization before the debit is entered.

Issue 12

Should there be a legal requirement as to the form of authentication necessary in an electronic funds transfer?

References

"Agreements", paras. 26-39

Issue 21

Comment

1. It appears that no country requires a funds transfer instruction to be in written form. It is for this reason that banks have been able to use various forms of electronic funds transfer techniques, including telex, computer-to-computer telecommunications, handing over of computer memory devices, and in some countries, oral instructions by telephone, without the need for express authorization by statute. In the

absence of legislation authorizing funds transfers to be made electronically, there seems to be no general requirement that a funds transfer instruction must be authenticated.

2. It may be thought to be desirable to require by law that all funds transfer instructions, including those in electronic form, must be authenticated. However, it may also be thought to be unnecessary since a bank could not substantiate a debit to an account unless it had a funds transfer instruction in a form on which it could rely in case of later dispute. This should be sufficient incentive for banks to be careful in their use of funds transfer techniques where the authentication is weak or non-existent. Furthermore, in many countries banking supervisors would consider it to be an unsound banking practice for banks to transfer funds on instructions that were not adequately authenticated.

3. If it was thought desirable to require by law that electronic funds transfer instructions must be authenticated, it may also be thought desirable to indicate the type of authentication which would be legally acceptable. Not only would this limit authentications to the types which the legislator deemed sufficiently secure, it would also assure that an authentication of the required type could be relied on to authorize a debit to the transferor's account, if there was otherwise doubt on this point.

4. However, it may be thought to be impracticable to specify by law in any meaningful way the manner in which an electronic funds transfer instruction should be authenticated. In contrast to authentication of a paper-based document, where a reasonably exhaustive list of means of authentication, including signature, could be given if desired, there are innumerable ways to authenticate a message sent by telecommunications. With the rapid development of technology, some current methods of authentication can be expected to become weaker while new and more secure forms of authentication can be anticipated.

5. As a result, it might be thought that any statutory provision concerning the authentication of an electronic funds transfer instruction should do little more than to authorize the use of means appropriate to the type of instruction involved. Questions as to the liability for loss caused by fraudulent or erroneous authentication might be dealt with separately, as might questions of which party bears the burden of proof as to whether the authentication was genuine or not.

Issue 13

Should sending banks be required to adhere to standard formats when sending funds transfer instructions?

References

"Agreements", paras. 47-54

ISO/DIS 7746/1.2, Banking-Standard telex formats for inter-bank payment messages—Part 1: Transfers

Comment

1. A sending bank can fail to adhere to a standard format in two ways. It can fail to use the proper message type when more than one message type is available and it can fail to include all of the information necessary for automated processing, including using improper abbreviations or other standard designations, placing the information in the improper field or placing it in the field for additional information when it should go into a specific data field. It is not a violation of the format rules to include incorrect information, such as the incorrect amount of the transfer, when the incorrect information is in the correct data field.

2. The rules of S.W.I.F.T. and similar networks specify the format which is to be followed for each message type. The only question remaining is the consequence to the sending bank for failing to adhere to the format. In contrast, even when the format rules for funds transfer instructions sent by telex, which are currently in an advanced stage of preparation and are closely modeled on the S.W.I.F.T. format rules, have become an international standard, they will not thereby acquire any legal force. Unless these format rules take on the character of norms of good banking practice, they could acquire legal force only by statutory or regulatory requirements that they be followed or by agreement of the parties.

3. The legal consequences to a sending bank of failing to follow the proper format rules could be twofold. The bank could be responsible for all errors on the part of subsequent banks that could be traced to the failure to adhere to the format. Exoneration on the grounds that a subsequent bank was itself negligent, in that it should have understood the message correctly, might be permitted, but it may be thought that exoneration on this ground should be rare. The second consequence for failing to follow the format rules could be the levy of a standard charge on the sending bank to be paid to the receiving bank for its effort in correcting the error of the sending bank. If receiving banks regularly claimed the charge, such a rule might have the beneficial consequence of making sending banks more conscientious in adhering to the format rules, to the benefit of all concerned.

Issue 14

Should a single electronic funds transfer format be required for all debit and credit cards in use in a country?

Reference

"Agreements", para. 54

Comment

1. The use of a single format increases the possibility of interchanging funds transfer instructions and clearing them through a single clearing channel. It also permits the shared use of terminals by cards issued by different

banks and other card issuers, although agreement on a common format does not necessarily imply shared use. If a single format is required or encouraged by the State, it is usually in order to bring about shared use.

2. The interest of the State in shared use may be to create a nation-wide system of electronic debit or credit cards. In some countries, proposed point-of-sale networks have been delayed awaiting a decision on a single format and shared facilities because retail interests wish to have only one terminal at each cash register. Both retail interests and the State may wish to assure that one card issuer is not able to establish a dominant position in point-of-sale systems by virtue of a format which does not permit the use of cards from other card issuers.

Issue 15

Where should customer accounts be considered to be located for the purposes of the legal rules governing funds transfers?

References

"Agreements", paras. 79-81

"Finality", paras. 62-68

Comment

1. So long as customer account records were maintained exclusively on paper, the usual rule was that the customer account was considered to be located for legal purposes at the place where it was maintained for bookkeeping purposes. When a bank had multiple branches, customer accounts were usually maintained at each branch, and therefore were located at the branch for legal purposes.

2. When a bank has a centralized data processing centre to which funds transfer instructions must be brought for processing, it may be thought that the basis for the old rule is eroded and that, at least for some purposes, the centralized data processing centre might be considered to be the location of the customer accounts. When a bank has remote access to the processing unit from terminals at some or all of its branches within the same legal jurisdiction so that relevant information can be entered to the account from these remote terminals, it may no longer be relevant to ask where the customer account is maintained since any or all of these locations may serve equally well. However, where paper-based funds transfer instructions are sent to the branch at which the account was opened for purposes of comparing signatures before the funds transfer becomes final, it may be thought that the account should remain localized at the branch even if the funds transfer data can be entered to the account from one or more other locations.

3. The question as to the localization of the account records may be relevant for knowing the place where a debit transfer instruction must be presented for honour.

the place where a credit must be sent, the place where the transferor of a debit transfer instruction can notify his bank of the withdrawal of the instruction and the place to which legal notices and attachments of an account can be delivered. In the case of legal notices and attachments of accounts, the relevant statute may specify a place where the notice or legal process must be delivered or the person to whom it must be delivered, which need not be connected to the place where the account is maintained.

Issue 16

Should the duty of a transferor bank in a credit transfer be limited to sending a proper credit transfer instruction to a proper receiving bank or should the transferor bank's duty be to see that the transferor's instruction is carried out?

References

"Liability", paras. 56-60, 100

Issues 3, 22, 30

Comment

1. This issue goes only to the question of the party responsible for the fulfilment of the funds transfer instruction. It deals neither with the standard of conduct to which any given bank or the banking system as a whole should be held responsible nor with the damages the transferor should be able to collect for improper performance. The extent of the duty of the transferor bank is of particular importance in international credit transfers and in domestic credit transfers in fragmented banking systems where a credit transfer may pass through several banks, communications systems or clearing-houses between the transferor bank and the transferee bank.

2. It may be thought that, since the transferor deals only with the transferor bank, has few independent means of identifying why a funds transfer was not carried out properly and can put little pressure on a distant or foreign bank to settle with it for the losses, the transferor bank should be responsible to the transferor for the proper performance of the funds transfer. This conclusion might be supported by the fact that banks participate in the design of the funds transfer system as a whole and the transferor bank normally decides which intermediary banks to use. Where the transferor bank itself was not at fault, it should normally be reimbursed for the loss, thereby eventually placing the loss on the individual bank at fault or on the system as a whole. It might be expected that one result of such a rule would be that banks might increase the pressure on other banks that consistently make loss-causing errors to improve their procedures. Further unification of banking standards and practice for international transfers might also be encouraged as an additional means of reducing loss-causing errors and delays.

3. However, it might also be thought that it would not be reasonable to hold the transferor bank responsible for errors occurring at other banks. This is particularly true of errors caused by the transferee bank, since the transferor bank seldom has any choice as to the identity of the transferee bank. Even if the transferor bank had a right of reimbursement, it may not always recover from the bank at fault in another country because of exchange control regulations or the like and it could be thought that the transferor bank should not be required to carry such risks of non-reimbursement. Furthermore, the transferor bank might be held liable to the transferor under the banking and legal standards of its country, whereas the bank in the country where the problem occurred may have been following different banking practices of its country. This raises the question whether the transferor bank's obligation should be limited to a duty to the transferor to warn him of the different banking practices of which it knew or should have known.

4. The alternative approach to liability is that each bank is directly responsible to the transferor for carrying out its obligations in respect of the funds transfer instruction. These two approaches are often determined by, or expressed by, the concepts of agency or of privity of contract. It may be thought that the consistent application of either of these concepts within a domestic legal system provides the transferor with a legal basis to hold responsible either the transferor bank or the bank at fault. However, it may be noted that in international transfers it is possible for the transferor not to be able to hold the intermediary bank responsible because of lack of privity of contract. It may, therefore, be thought desirable for a clear and consistent rule to be available, especially in international funds transfers.

5. Consideration might be given to the imposition of a higher funds transfer fee in exchange for which the transferor bank would take on a heavier burden of responsibility for losses caused by errors or delays of other parties in the funds transfer system as well as for its own errors or delays.

Issue 17

Is the transferee bank responsible to the transferor, to the sending bank or to the transferee for the proper fulfilment of its obligations in regard to a credit transfer?

References

"Liability", para. 93

"Finality", paras. 5-20

Comment

1. The transferee bank in a credit transfer may be regarded as being in a legally ambiguous position. On the one hand, its contract with its customer calls on it to receive transfers for credit to the account. In this

respect the transferee bank would seem to be contractually responsible to the transferee for the proper fulfilment of its obligations as soon as it has received the credit transfer instruction from the sending bank. Any delays on its part in processing the instruction should be consistent with that contractual obligation. On the other hand, since the funds transfer does not become final and the transferor has not completed his obligations to the transferee until the transferee bank performs the requisite act bringing about finality, the transferee bank might have an obligation to the transferor (or to the sending bank) to act promptly and accurately to perform that act.

2. One approach to determining the party to whom the transferee bank should be liable for failure to carry out the funds transfer instruction properly would be to fix a point of time before which the transferee bank acts on behalf of the transferor (or the sending bank) and after which it acts for the transferee. This point of time might be the moment when the funds transfer becomes final. Alternatively, it may seem reasonable for the transferee bank to be responsible both to the transferor (or to the sending bank) and to the transferee.

Issue 18

Should public telecommunications carriers, private data communications services, electronic funds transfer networks and electronic clearing-houses be responsible for losses arising out of errors or fraud in connection with a funds transfer instruction?

References

"Liability", paras. 23, 24, 68-73, 78-81

Issue 16

Comment

1. The question whether public telecommunications carriers should continue to be exonerated from all liability for losses arising out of a lost or delayed message or from changes in the content of the message has been re-opened because of changes in the nature of the services offered and as a result of the deregulation or privatization of the service in some countries. However, in the absence of such liability, consideration might be given as to whether the transferor or one of the banks should bear the loss. In favour of the transferor bearing the loss is that the funds transfer is undertaken on his benefit and the loss occurs through no fault of any party who could be held liable. In favour of the loss being borne by one of the banks is that the banks are in the best position to design a funds transfer system using the public carriers where delays or errors would be brought to the attention of the sending or receiving bank, thereby permitting prompt correction. Amongst the banks which might be selected to bear the loss are the transferor bank, especially if the transferor bank is responsible for the proper performance of the entire funds transfer, and the sending bank of the instruction that was lost, delayed or whose content was altered.

2. Private data communications services, electronic funds transfer networks and electronic clearing-houses may contract with the participating banks to limit or exclude their liability for lost, delayed or altered funds transfer instructions. It may be thought that contractual allocation of loss between these entities and the participating banks should not violate public policy. However, consideration should be given as to whether the effect of these contractual provisions is to place the loss on the transferor. It might be thought that there is less reason for the transferor to bear this loss than when the loss occurred with the public carrier, since the networks and clearing-houses are an integral part of the banking industry and the banks have a choice as to whether to use the private data communications services for sending funds transfer instructions.

3. It might be thought that the telecommunications carrier, data communication service, electronic funds transfer network or electronic clearing-house should be liable for loss caused by the fraud of its employees. However, it might also be thought that there are limits to the extent to which an employer should be responsible for the acts of its employees, especially when those acts are illegal. A distinction might be drawn between losses from fraud made possible by access to account records or to equipment as part of the employment relationship, for which the employer would be responsible, and losses from fraud made possible by knowledge acquired by the employee in the course of his employment, for which the employer would not be responsible.

Issue 19

Should a bank be free from responsibility for errors or delayed funds transfers caused by failures in computer hardware or software?

Reference

"Liability", paras. 64-67

Comment

1. Although bank computer hardware and software have reached high degrees of reliability compared to only a few years ago, on occasion errors occur and funds transfers are lost, delayed or altered because of computer failure. On the one hand it may be thought that technical problems of this nature are beyond the control of a bank and that the bank should be free from responsibility for any losses caused to customers as a result. If free to do so, banks often include a provision to this effect in the contracts they have with their customers.

2. On the other hand it may be thought that the degree of computer reliability is such that computers should be treated the same as any other type of equipment used by banks. Computer failure may be the result of improper equipment or software or inadequate maintenance, and the consequences of computer failure can be reduced by advance planning, which may include the availability of redundant equipment, back-

up power supplies, plans for using alternative means of effecting funds transfers and, in general, prompt action by the bank. As a result, a generalized exoneration from liability may be thought not to be justified, but an exemption from liability for computer failure might be justified when the bank could not be expected to have prevented the failure or reduced its consequences.

Issue 20

Should a bank be liable to its customer for having entered a debit or credit to the account according to the account number indicated on the funds transfer instruction it has received if the name on that account does not correspond to the name given on the funds transfer instruction?

Reference

"Agreements", paras. 44-46

Comment

1. The accounts to be debited and credited may be indicated on the funds transfer instruction by name, by account number, or by both name and account number. Banks which keep customer account records using automatic data processing normally rely upon the account number alone for processing. This may be the only possible means when the instructions are batch-processed. However, it should be possible to compare the account name when the instruction has been transmitted individually by telecommunications.

2. It is unlikely that entering debits and credits by account number alone needs legislative authorization under the law of any country. However, it may be thought that it would be useful to indicate whether the bank should be liable for any loss which might occur if the name of the party to be debited or credited according to the funds transfer instruction did not correspond to the name on the account. The name on the instruction and the name on the account may fail to correspond because of fraud, error, including error by the transferor, or because the transferor did not know the correct name of the account.

3. A rule fully supportive of the increased use of automatic data processing might be that a bank that entered a debit or credit according to the account number on a funds transfer instruction it received would not be liable even though the entry was made to an account bearing a different name from that on the instruction. Any loss would be borne by the transferor or the bank at which the incorrect account number was first entered on a funds transfer instruction. This might be expressed as a rule that in case of conflict between the account number and the account name, the account number prevailed.

4. It may also be thought that the bank could be expected to compare the account number and the account name and discover any discrepancy between them. In particular, this might be done with high-value

funds transfers received by telecommunications. If it chooses to enter debits and credits on the basis of account numbers alone, it is for the benefit of the bank, and the customers should not suffer as a result. If this position is taken, consideration might be given as to whether the transferee bank or the transferor should suffer the loss where the discrepancy was caused through the error of the transferor or the fraud of one of his employees. The normal rule in such cases would probably be that the transferor bore the risk of such loss. If loss were attributed to the transferee bank, it would be a recognition that the loss could have been prevented by the subsequent actions of the transferee bank.

Issue 21

Should the bank or the bank customer carry the burden of proof whether a debit to the transferor's account was authorized by him or occurred through his fault?

References

"Liability", paras. 13-21

Issue 7

Comment

1. The issue of the burden of proof involves litigation. If the customer has the burden of proving that a debit to his account was unauthorized and can neither meet that burden nor shift to the bank the burden of proving that the debit was authorized, the customer will fail in his claim. If the bank has the burden of proving that the debit was authorized, the likelihood that the customer will succeed in his claim is increased.

2. In issue 7 it was noted that in almost all countries computer records are accepted as evidence of the transactions they record. Although all legal systems that accept computer records as evidence permit a party to raise doubts as to the correctness of the record by showing that the computer system was improperly designed, insufficiently maintained or that improper procedures were used to enter the data so that accuracy of the data entries was not assured, in most disputes as to whether a funds transfer instruction had been properly authorized electronically, it would be a practical impossibility for the customer to raise such doubts about the bank's computer system or procedures. This is particularly true of small-value funds transfers, but it would also be true of most large-value funds transfers.

3. In many cases when a customer claims that the funds transfer which was initiated through a customer-activated terminal was not authorized, the surrounding circumstances may either substantiate his claim or lead to strong doubts of its validity. However, when the surrounding circumstances neither substantiate nor raise serious doubts about his claim, a decision as to whether the customer's account may be debited often rests on whether the customer or the bank bears the burden of proof. The most frequent current example is

the withdrawal of cash from an automatic cash dispenser, but the issue can be expected to arise frequently in point-of-sale transactions as well. In both cases the party who issues the funds transfer instruction departs with the cash or the goods leaving no audit trail other than the funds transfer instruction itself. A less frequent, but individually more important, case involves fraudulent large-value transfers where knowledge as to the identity of the fraudulent party might be relevant to the allocation of loss to the bank or to its customer.

4. It may be thought that it is so unlikely that the record of the account to be debited could be in error as a result of undetected computer error or that a third person could fraudulently access the computer without the aid or the negligence of the customer that the burden of proof should properly rest upon the customer to show that the entry at the customer-activated terminal was made without his aid and was not the result of his negligence. It is this argument that supports the provisions found in many bank-customer contracts that the customer is responsible for all transactions initiated by use of his debit card or other access device unless he has reported that the card was lost or that the means of access was compromised in some other way.

5. It may, however, be thought that fraudulent access to customer-activated terminals is a known and serious problem for which the banking industry should be responsible to its customers. It might even be thought that it is the duty of the banking industry to devise means of access to the computer through customer-activated terminals that are so secure that ordinary negligence on the part of the customer would not be sufficient to compromise them. It could also be thought that, unless such secure means of access are available, the banking industry should install customer-activated terminals only with great caution. This might lead to a conclusion that the bank in question should not be allowed to debit the customer's account unless the bank could show that the means of access to the computer was so secure that it was impossible, or that it was highly unlikely, for the entry to have been made unless the means of access had been compromised in the hands of the customer. At present this would probably lead to the result that the bank could not debit its customer's account unless surrounding circumstances indicated that the fraud could be attributable to him. However, as more secure forms of authentication at customer-activated terminals become available, it could be expected that banks would be able to sustain this burden of proof with greater success.

Issue 22

Should the customer or the relevant banks carry the burden of proof as to the source of error or fraud causing loss in effectuating a funds transfer?

References

"Liability", para. 59
Issues 7, 16, 21

Comment

1. This issue can arise in two principal ways. The first is that the customer claims to have initiated a funds transfer instruction but the bank has no record of it. Although the most frequent cases involving loss will undoubtedly arise from instructions alleged to have been sent from a customer-activated terminal at the customer's place of business, once funds transfers from automated teller machines or home banking terminals become common, cases are bound to arise involving such matters as lapsed insurance contracts for failure to pay the premium which was due. It could be expected that in most cases when the instruction was sent from a terminal at a place of business, the customer's computer would retain a record of the transmission. The issue may then focus on which party bears the risk of loss of the message, the customer or the bank. In the case of an automated teller machine or a home banking terminal, there will often be no paper receipt or computer record available to the customer to prove the transmission. Without such a receipt or record and in the absence of regular business routines by the non-commercial customer that would lend credence to his claim, it may be thought that the customer should carry the burden of proof.

2. The second way in which the issue can arise is that the funds transfer instruction was lost or delayed or contained an error when it arrived at the transferee bank but the source of the problem is unclear. When the rule selected imposes responsibility on the transferor bank for the proper performance of the entire funds transfer, it can be expected to carry the burden of proof that the loss, delay or error occurred in a manner which exonerates the bank from liability (see issue 16). When the rule selected does not impose such a responsibility on the transferor bank, the transferor could be expected to carry the burden of proof of showing which bank is liable for the loss, delay or error. Normally, the audit trail should be sufficiently clear to show the bank where the problem occurred. However, the records establishing the audit trail would be in the complete control of the banks, and in the case of an international funds transfer, some of those banks may be foreign banks with the consequent increased difficulty of securing information. If the records of the banks disagreed, the transferor would have no independent means of carrying this burden of proof. In addition, the transferor may be required to show that the loss, delay or error occurred through the negligence or other fault of the bank in question, in which case he could be expected to carry the burden of proof as to the cause of the problem.

Issue 23

Should the funds be required to be made available to the transferee within specific periods of time after the transferor bank receives a credit transfer instruction? If it should, how should the period of time be determined?

References

"Agreements", paras. 55-78

Issues 16 and 27-29

ISO/DIS 7746/1.2, Banking-Standard telex formats for inter-bank payment messages—Part 1: Transfers

ISO/DIS 7982/1, Bank telecommunication—Funds transfer messages—Vocabulary and data elements (as revised on 14 November 1984)

Comment

1. This issue is concerned only with the question whether a time-limit should exist within which credit transfers should be completed and, if so, what the source of that time-limit should be and which banks should be liable for failure to meet it. It is not concerned with the period of float that might be created in credit transfers, since the period of float can be made longer or shorter than the period of time which is required to effect the credit transfer by establishing an interest date earlier or later than the entry date.

2. In order for a transferor to initiate credit transfer instructions in time to meet payment deadlines, the time necessary before the transferee will have available funds must be known. Banks are increasingly able to give precise estimates of the time necessary for inter-bank credit transfers to be completed, since electronic fund transfer techniques are more reliable in this regard than are paper-based credit transfers. This is true for both domestic and international credit transfers.

3. It may be thought that, if transferor banks offer a service which contemplates that funds will be available to the transferee on a specified pay date, transferors will tend to rely on that fact in planning their transactions. In such a case, the transferor may well have a basis for claiming for losses that might have occurred because of unexcused delay.

4. It may be thought that the transferor bank should be required to act upon a credit transfer instruction it has received within a limited period of time appropriate to the type of funds transfer involved. If it was felt necessary, it should be possible to agree on standard time-limits for all types of credit transfer instructions in use in a country. These time-limits should, of course, take into consideration the normal causes of delay which prevent all funds transfers from being completed within the optimal period of time. Where the credit transfer is a one-bank transfer, the bank might be held responsible for completing the transfer within the appropriate period of time. A different period of time might apply when the transferee's account was at another branch within or outside the country where the transferor held his account and the data processing of the transferee's account was performed at a different location from that servicing the transferor's account.

5. In a funds transfer involving two or more banks, each of the banks receiving the instruction would seem also to have an obligation to act within a limited period of time. Where the receiving bank received the funds

transfer instruction through a network, the period of time might be established by network rules. In other cases, it may be established by banking custom, by inter-bank agreement, or by law. This obligation of the receiving bank might be considered to run either to the transferor or to the sending bank. In either case, there would be an increased likelihood that the estimated time for the entire funds transfer would be accurate.

6. Since the transferor must rely upon the transferor bank to furnish the estimate of time necessary for the funds transfer and to serve as the entry point to the entire funds transfer system, it seems appropriate to consider whether that bank should be legally responsible for the funds transfer being carried out on schedule. On the other hand the transferor bank cannot control the actions of the other banks in the chain, and can rarely even select the transferee bank (see issue 16).

7. When the transferor specifies a pay date, i.e. the date on which the funds are to be made available to the transferee, the generalized obligation of the transferor bank or other banks in the chain becomes more specific. The acceptance of a funds transfer instruction with an indicated pay date might be understood to create a contractual obligation on the part of the transferor bank that the funds would be available to the transferee by that date. At a minimum it might be thought that the transferor bank would be obligated to include the pay date in its funds transfer instruction to the next bank in the chain. However, since standard message formats for telex and computer-to-computer funds transfer instructions do not contain a field for the pay date, that information would have to be included in the field for receiver information. It may also be noted that the term "pay date", which had been in earlier drafts of the proposed vocabulary for use in banking telecommunications, has been eliminated from the most recent version.

8. It might be thought that, when the transferor had provided insufficient time to be certain of meeting the pay date, the transferor bank would also be obligated to inform the transferor of that fact. Furthermore, if a receiving bank is not obligated to credit its credit party until it has received value, the transferor bank as sending bank would be obligated to provide its receiving bank with value in time for that bank to act within the necessary period of time.

Issue 24

How often should a bank be required to send its customers a statement of account activity?

Reference

"Liability", paras. 47-50

Comment

1. A bank and its customer could agree that a statement of account activity would be given more often than might be required by law. This would be

particularly true of business accounts where daily statements of account activity are often given. Therefore, this issue relates only to the minimum requirements that might be imposed by law.

2. In those banking systems where a notice is given whenever a debit or a credit is entered to an account, that notice serves as a statement of account activity. In other banking systems where a notice of debit or credit is not given automatically, periodic statements might normally be expected. However, an appropriate minimum requirement might vary for different types of account and different levels of account activity. In some cases, such as where the account is secret and designated only by number, it might be considered inappropriate for any periodic statement of account activity to be sent in the mail to the customer. Therefore, it might be thought that the frequency of statements of account activity is a matter which could be left to the agreement of banks and their customers.

3. It may, however, also be thought that for at least certain types of accounts minimum requirements established by law would be appropriate. This would most likely occur with regard to non-commercial accounts in countries where a notice of debit or credit was not necessary for the debit or credit to become final. This may be thought to be of increasing importance as larger numbers of individuals than in the past use bank accounts for funds transfers. It may be thought that these individuals are less likely to keep adequate records of their funds transfers. Where the transferor has an unqualified right for a period of time to demand reversal of a debit transfer made pursuant to a standing authorization to debit, the transferee would have an interest in knowing that the transferor had received notice of the debit and that the time for reversal had begun to run. Furthermore, the increased amount of fraud that has been reported as a result of the use of customer-activated terminals may be thought to call for relatively frequent statements of account activity as an aid in discovering the fraud.

4. If a statement of account activity is required by law, some consideration might be given as to whether the statement must be on paper and be sent to the customer or whether the requirement is satisfied when the statement is made available at the bank. In particular, the statement might be made available through the use of a customer-activated terminal that the customer has in his home or place of business or through an automated teller machine.

Issue 25

How much time should a bank customer have to notify his bank of improper entries to his account?

Reference

"Liability", paras. 51-54

Comment

1. In some countries the period of time during which a bank customer should notify his bank of improper entries to an account is a part of the law concerning funds transfers. In other countries the period of time is determined by general rules of law. In either case the period of time should be relevant to current banking procedures.

2. The total period of time available to a bank customer to notify the bank of improper entries to his account, starting from the time when the entry is made to the customer's account, is determined both by the event which causes the period to commence to run and the duration of the period. The period could commence when the entry was made. In some countries, in accordance with general rules of law, the period commences when a formal balance of the account is stated by the bank, which may be semi-annually or annually. It may be thought, however, that it is more relevant for the period to commence when the bank gives the customer a statement of account activity showing the entry, since that is the event that brings its existence to the attention of the customer. If a statement of account activity is available to the customer through a customer-activated terminal, it might be thought that the period of time should commence to run as soon as the entry could show on the terminal on a request by the customer. If no statement of account activity is sent to the customer or available through a customer-activated terminal, the period might commence when information that the entry has been made is available to the customer at the bank on request.

3. When the period of time for the customer to notify his bank of an improper entry is limited only by the statute of limitations or period of prescription, i.e. the limitation period for commencing legal action, the period is often several years long, and may be considerably longer. It may be thought, however, that a shorter period of time, which might be measured by months rather than years, would be appropriate for giving notice. Especially where the improper entry appears to have arisen out of fraud or where the entry was made to an incorrect account, prompt notice to the bank may permit the bank to pursue the fraudulent party or correct its error by entering the amount to the correct account.

4. Consideration might be given as to whether there should be different periods of time for different types of account or for different types of customers. It might be thought, for example, that commercial customers should have a shorter period during which to notify the bank of an improper entry than would most non-commercial customers, since it can be assumed that commercial customers reconcile their statements of account activity sooner and with more care. Furthermore, the average size of individual commercial funds transfers is larger than non-commercial funds transfers, making it of greater importance that individual errors or fraud be found promptly.

5. It may be thought that the period of time available to a bank customer to give notice of an improper entry should be a matter of mandatory law not subject to being reduced by agreement between banks and their customers. However, it may also be thought that, particularly in the context of commercial accounts or of large-value funds transfer networks, it would be desirable for the parties to be able to adjust the legally prescribed period of time to the circumstances of the account and its activity.

Issue 26

Should there be a clearly articulated error resolution procedure?

Reference

"Liability", para. 55

Comment

1. Since bank customers may question a certain number of entries to their account which may have been made in error or may be a result of fraud, every bank will of necessity have a procedure for investigating and resolving those errors. In some banks the procedure may be unwritten and informal. In many banks, and particularly banks with a large number of accounts and entries, the procedure tends to be written and formal.

2. It may be thought that every bank should have a written error resolution procedure. Such a procedure might be expected to contain certain minimum requirements in regard to the time the bank has to respond to the enquiring customer and the information that must be contained in the response. It may also be thought that the error resolution procedures of the bank should be made known to the bank's customers in an appropriate form.

3. Since error or fraud in a funds transfer often involves actions of banks other than that of the enquiring customer, any such procedure adopted by only one bank would of necessity be limited in its scope. Particular difficulties might be encountered where the other banks involved were in other countries and those banks had different standards in regard to investigating and correcting errors or reporting on apparent fraud.

4. It may be thought, therefore, that inter-bank agreements might be developed regarding error resolution procedures. These agreements might be incorporated into the rules of funds transfer networks, adopted by banking associations or by bilateral agreements between correspondent banks. It could be expected that the provisions of any such agreements relating to small-value funds transfers might be significantly different from those in agreements relating to large-value transfers.

5. In some countries it may be thought useful to prescribe by law the required error resolution pro-

cedures. It may be thought that, especially in regard to non-commercial accounts, mandatory error resolution procedures are an important measure of protection to bank customers who are otherwise in a weak position to argue with their bank about an alleged error on the part of the bank. However, it may also be thought that any error resolution procedure prescribed by law would be apt to be either too general to be of much protection to bank customers or so detailed as to generate unnecessary expense. It may also be thought that in most countries experience does not necessitate legislation on this point.

Issue 27

Should either the transferor or the transferee recover interest for a delay of a funds transfer?

References

"Agreements", paras. 55-78

"Liability", paras. 92-95

Issues 23, 30

Comment

1. Issue 23 discussed whether the banking system should be required to make a credit transfer available to the transferee within specific periods of time after the transferor bank receives a funds transfer instruction. Implicit in that question was the question of the nature of damages that might result from a failure of the banking system to meet the time schedule. The most natural element of damages for delay in paying a sum of money on time is interest.

2. It should be noted here, as was alluded to in issue 23, para. 1, that in some banking systems an implicit interest charge is built into the funds transfer schedule by debiting the transferor with an interest date of day 1 and crediting the transferee with an interest date of day 3. This implicit interest charge is not present in other banking systems where both the debit and the credit have the same interest date, e.g. day 3. However, in either case if the transfer is delayed and the credit is entered with an interest date of day 5, there has been a two-day loss of interest to the transferee.

3. When a large-value funds transfer is delayed, the transferee's interest loss may be significant. However, in some banking systems it may be as difficult to determine which of several rates of interest is the appropriate rate of interest to compensate the transferee as it is to determine the appropriate rate of interest to compensate the transferee bank in case of delay (see issue 30). One solution would be to give the transferee the rate of interest he would have received in the account. This is the solution implicit in the procedure of back-dating the credit mentioned in paragraph 4, below. Another solution would be to tie the interest rate used in calculating compensation to the transferee to the interest rate used for inter-bank compensation as described in issue 30.

4. Although it is the transferee who has suffered the lost interest, it is not clear from whom the transferee should be able to recover. It could be thought that the transferee should be able to recover from the transferor if the delayed entry of the credit constituted breach of the underlying contract. If this were to happen and if the delay did not occur at the transferor bank, the question would arise as to whether the transferor could seek reimbursement, and from which bank. If the delay occurred at the transferee bank, the transferee should probably be able to recover from it on the grounds of the pre-existing contract of account. However, if the delay appeared to have occurred at any other point in the funds transfer chain, including at the transferor bank, the transferee may not have a direct claim against that party. A practice which reduces the theoretical problems is that the interest date of the credit in the transferor's account may be back-dated to the appropriate date, with interest and fees adjusted to what they would have been if the transfer had not been delayed. In most cases this procedure would compensate the transferee adequately for the delay.

5. In the vast majority of delayed small-value transfers no claim for compensation for lost interest could be expected. The size of the individual claim would be small and transferees receiving small-value transfers often are not aware of the appropriate interest date for the funds transfer. If delay in completing small-value transfers beyond the established time-limits is a serious problem in a banking system, consideration could be given to administrative solutions that would eliminate this effect of delay on the transferee. One such solution might be to provide that the interest date of the debit to the transferor and the interest date of the credit to the transferee must be the same or separated by a specific number of days.

Issue 28

Should either the transferor or the transferee recover exchange losses for delay of a funds transfer?

References

"Agreements", paras. 55-78

"Liability", paras. 96-97

Issues 23, 27

Comment

1. As is true of a claim for lost interest, a claim for exchange loss can be made only if the time schedule for the funds transfer is so precise that the time when the exchange should have been made is clearly determined or determinable. In a period of floating rates with daily movements of several per cent between major trading currencies not unknown, the precise determination of the hour or even the minute when the exchange should have been made could be relevant in particular cases.

2. Putting aside the influence of hedging operations by the parties, the transferor may suffer exchange loss if his obligation to pay is denominated in a foreign currency and his currency of account devalues against the currency of payment between the time when the exchange should have been made and the time when it was made. Similarly, the transferee may suffer exchange loss if the currency of payment is a foreign currency which devalues against his currency of account between the time when the exchange should have been made and the time when it was made. The fact that there was an exchange loss, and the amount of that loss, might be established by a subsequent cover purchase of the foreign currency by the transferor or transferee, as the case may be. The transferee suffers no exchange loss during the transfer itself if the currency of the account to which the transfer is credited is the same as the foreign currency of payment. However, consideration might be given as to whether a claim for exchange loss should be allowed when the transferee intended, or was required by currency control regulations, to sell the foreign currency promptly after receipt and the transferor knew of this intention or requirement.

3. Where the exchange loss occurred because of delays at a bank prior to the transferee bank, the same difficulties exist in determining from whom, and in what manner, the transferee could recover his loss as there are in regard to recovering lost interest arising out of delay (see issue 27).

4. If no recovery for exchange loss is permitted, the transferor and transferee are required to accept the rate of exchange prevailing when the exchange was made in fact. If recovery of exchange loss is permitted, consideration might be given as to whether the customer, i.e. transferor or transferee, as the case may be, should have the choice between the rate of exchange prevailing when the exchange should have been made and the rate of exchange prevailing when it was made in fact. Alternatively, the governing rate could be deemed to be the rate of exchange prevailing when the exchange should have been made. In this latter case the banks would have the right to apply that exchange rate to the transaction even though the rate had moved in favour of the customer before the exchange occurred. As noted in the chapter on liability, para. 97, in the draft Convention on International Bills of Exchange and International Promissory Notes, the holder of the instrument is given the choice of dates "in order to protect him against any loss he may suffer because of speculation by the party liable".

Issue 29

Under what circumstances should the bank be liable for consequential damages?

References

"Liability", paras. 98-100

Issues 16, 23

Comment

1. Although delay or error in the processing of a funds transfer instruction can usually be fully compensated by payment of interest, or exchange loss and the making of similar financial adjustments, in a few cases the failure to complete the funds transfer by the anticipated date may cause consequential damages to the transferor arising out of the cancellation of a contract, incurring of a penalty or forfeiture of rights with damages far exceeding compensation measured as interest.

2. It may be thought that, in accordance with the general rule, the bank should not be liable for consequences it did not foresee and could not reasonably have foreseen. Since a delay in executing a funds transfer only rarely causes such loss, even where the amount transferred is large, liability for consequential damages would be correspondingly rare. This might be thought to be in accordance with the fee schedule for funds transfers since that schedule is usually too low to support even occasional claims for the large damages which might result.

3. However, there are occasions when the transferor bank knows the purpose of the transfer and the consequences that would follow from delay or error in its transmission. It might be thought that in such cases the normal rules of liability should follow. If this approach was taken, the transferor bank would be liable for the consequential damages arising out of its own errors or delays in processing the funds transfer. On the other hand, banks often know a considerable amount about the affairs of their customers without that knowledge being available to the funds transfer department. It could be questioned who within the bank should have the requisite knowledge for the bank to be responsible for consequential damages.

4. If the transferor bank was responsible for the entire funds transfer, including the actions taken by other banks (see issue 16), it would be responsible for consequential damages arising out of any delay or error in the funds transfer. However, if the transferor bank was responsible only for its own actions and the delay or error occurred at a subsequent bank in the transmission chain, the question would arise whether the subsequent bank should be bound by the knowledge of the transferor bank or whether it could defend on the grounds of unforceability.

5. It should be noted that under current banking practice it would be unusual for the transferor bank to explain to its receiving bank the potential consequences if the funds transfer instruction was delayed. However, there is no intrinsic reason that it should not have such a duty. At a minimum it might be thought that the transferor bank should include the pay date in the funds transfer instruction (see issue 23). It might also be thought that inclusion of such a pay date would give the banks in the transmission chain the knowledge that some business consequences might occur if the funds were not available to the transferee by that date, even if they did not know the exact nature of those consequences.

6. It may be thought that there should be a standard procedure available whereby a transferor could notify the transferor bank that it was of particular importance that the funds transfer be completed on time. An additional fee might be charged based on a special priority procedure required for handling the funds transfer. Such a procedure would seem to have its greatest utility in international funds transfers where the possibilities of delay or error are the most significant and the difficulties of recovering substantial damages from an intermediary bank at fault are the greatest, although it might also be instituted for domestic funds transfers.

Issue 30

Should there be special rules governing the inter-bank liability for late reimbursement or for erroneous funds transfers?

Reference

Issue 16

Comment

1. In addition to any loss to the bank customers (transferor and transferee) that may be caused by an error on the part of the sending bank, the receiving bank may also suffer a loss. Although general rules of law would furnish a basis for determining when liability exists and for calculating the loss, they may not be completely satisfactory when applied to banking situations without interpretation. Furthermore, the general rules of law differ from one country to another and the use of conflict of laws to determine the appropriate compensation may be thought not to be satisfactory for the routine calculation of compensation. Therefore, it may be thought desirable for inter-bank rules to be prepared, especially for international funds transfers.

2. If the receiving bank should be required to pay damages to its credit party for losses arising out of errors or delay experienced prior to receipt of the funds transfer instruction by the receiving bank, that bank could be expected to receive reimbursement for the loss from the sending bank. An inter-bank agreement might be prepared to govern that reimbursement. A threshold question would be whether any such agreement should cover matters that would otherwise be governed by general rules of law. Other issues might include: Would the receiving bank receive reimbursement from the sending bank if the error was caused by yet an earlier bank in the chain? Could the receiving bank receive full reimbursement from the sending bank for all damages it has paid or would it have to justify the damages by showing a court order or arbitral decision? If the damages paid to the transferee consisted of interest only, should the transferee bank recover that interest as reimbursement in addition to the inter-bank interest discussed in the following paragraph? Similar questions are faced and might be settled by an inter-bank agreement if, as suggested in Issue No. 16, the transferor bank in a credit transfer is responsible to the

transferor for the proper performance of the entire credit transfer.

3. When the receiving bank has credited its credit party as requested but has not received reimbursement on the date indicated, there is no loss to the credit party but there is a loss of interest to the receiving bank. Similarly, when a sending bank requests a receiving bank to correct an error of the sending bank by entering a credit to the account of the credit party as of a date earlier than the date of receipt of the instruction, the receiving bank has lost the opportunity to invest the funds it should have received at that earlier date. A contrary situation occurs when a bank sends a credit transfer instruction to the wrong receiving bank and that bank, at the request of the sending bank, subsequently reverses the credit entered to the account of its credit party and returns the funds to the sending bank. The receiving bank has had the use of funds to which it should not have been entitled. In some legal systems the receiving bank may be obligated to reimburse the sending bank under a theory of unjust enrichment or the like even though the error was that of the sending bank.

4. In many banking systems there may be more than one interest rate that might appropriately apply to the inter-bank compensation. For international funds transfers there would certainly be more than one applicable rate. It may, therefore, be thought to be useful for inter-bank rules to specify the conditions under which interest would be given by one bank to the other as compensation and to give appropriate formulas for calculating the amount of interest. Furthermore, errors are time-consuming to rectify. Therefore, it might be thought appropriate for inter-bank rules to specify an amount of compensation to be paid by a sending bank to the receiving bank for the inconvenience and time spent in rectifying the error.

Issue 31

What should be the consequences of a funds transfer or funds transfer transaction becoming final?

Reference

"Finality", paras. 49-96

Comment

1. The consequences of finality of a funds transfer are not the same in all countries. Legal results which are the consequences of finality in some countries may arise before or after finality as viewed in other countries, or in the same country may arise at different times depending on the type of funds transfer involved. Therefore, there could be no universal list of consequences which should be described as the result of finality; there can be only a list of consequences often associated with finality of a funds transfer. The exact time when each consequence occurs must be determined separately for each type of fund transfer in each country.

2. The consequences most often associated with finality are that:

(a) The balance in the transferor's account is reduced and the funds transfer can no longer be stopped by the death of the transferor, the commencement of insolvency proceedings against him, his supervening legal incapacity, attachment of his account, set-off by his bank or withdrawal of the funds transfer instruction by him;

(b) The credit balance in the transferee's account is increased and is subject to action by his creditors;

(c) The transferee has a right to withdraw the funds and might earn interest on the new credit balance (or cease paying interest on the previous debit balance);

(d) The transferee bank may be precluded from debiting the transferee's account to correct alleged erroneous credits to that account without the permission of the transferee;

(e) An underlying obligation between the transferor and transferee may be discharged.

3. Essentially the same consequences in respect of the accounts of one bank with another seem to occur as the result of finality of a funds transfer transaction between two banks. However, finality of the funds transfer transaction may also bring with it the obligation of the receiving bank to credit the account of its credit party, to pay interest on the new balance in the account of the credit party, to send a credit advice to the transferee or a new funds transfer instruction to the next bank in the transmission chain and to make the funds available to the credit party.

Issue 32

Should funds transfers be final for any or all purposes on the happening of a specific event or at a particular point of time in the day?

Reference

"Finality", paras. 4-48

Comment

1. A funds transfer may be final either on the happening of a specific event, e.g. the entry of the debit or the credit to the relevant account, on the happening of an event which is common to a large number of funds transfers, e.g. the placing of a computer memory device containing funds transfer instructions into the computer for processing, or at a specific time of the day, e.g. midnight of the day on which the funds transfer instruction was received or on which the debit or credit was entered. If the funds transfer becomes final upon the happening of a specific event, the rule treats each funds transfer as a unique transaction. If the funds transfer becomes final on the happening of an event common to a large number of funds transfers or at a particular time of the day, the rule places each funds transfer within the normal data processing cycle for the type of funds transfer in question.

2. Although some countries may find it desirable to establish a relevant event or point of time as the moment of finality for all types of funds transfers and for all consequences, other countries may find it preferable that certain funds transfers become final for some or all purposes on the happening of events while other funds transfers become final at a particular time of the day.

3. The one event which is likely to make all types of funds transfers final in all countries and in regard to all consequences is the handing over of cash by the transferor bank (debit transfer) or the transferee bank (credit transfer) pursuant to the funds transfer instruction. However, when the cash is handed over by a third bank, with or without recourse, the funds transfer is not considered to be final until the funds transfer instruction has been honoured by the transferor bank or transferee bank as the case may be. In the light of these prior rules, consideration may be given as to whether a funds transfer is final when the transferee withdraws cash from a cash dispenser in an off-line shared system where the bank maintaining the cash dispenser is not reimbursed and the debit is not entered to the customer's account until a later time.

4. Some types of funds transfer seem to call for fixing different events or points of time for the various consequences flowing from the funds transfer. For example, the transferor loses the right to withdraw a funds transfer instruction when it is issued if the instruction is of a type which the transferor bank guarantees to honour. Because of the general desirability of certainty and of early finality in high-value electronic funds transfers, network rules often provide that the funds transfer instruction is not subject to reversal by the sending bank (or its instructing party) once it is sent. In the case of a net, or net-net, settlement network, the funds transfer may become final at the time when settlement occurs in the sense that there is then no longer the possibility that the funds transfer instruction may be returned to the sending bank because of a failure to settle, although other network rules may require immediate irrevocable credit to the account of the credit party.

5. Where the funds transfer instructions are processed in batch, it may be considered desirable for the rules on finality to fix a specific time of the day when the funds transfers become final, since batch processing of funds transfer instructions does not lend itself as well as does individual processing to fixing a single event during the processing period as the relevant event for finality. However, if a single event is desired, it has been suggested that it be an event which is easy to identify, such as the insertion of the computer memory device containing the batch of funds transfer instructions into the computer.

6. Furthermore, it may be considered desirable, as it is in some countries, to permit the data processing to take place in any order convenient to the bank. If this is to be permitted, it may be considered desirable to permit a bank to enter all debits and credits without regard to

account balances or other reasons for refusing to honour the funds transfer instruction and to reverse the entries that the bank later determines it should not honour. If this is considered desirable, it may also be considered desirable to fix a maximum period of time during which the bank could reverse the entries, which would probably be best measured as terminating at a particular time of the day.

Issue 33

What should be the effect on a credit transfer between two customers that a funds transfer transaction between two banks has become final?

References

"EFT in general", paras. 26-28

"Finality", paras. 23-30, 58, 61, annex

Issue 4

Comment

1. The relationship between the finality of a funds transfer transaction between two banks and a credit transfer between the transferor and transferee is emerging as one of the more important legal issues to be faced in the design of high-value funds transfer networks and in the potential preparation of rules to govern international funds transfers.

2. The issue seems not to have raised concerns so long as high-value electronic funds transfers were made only by telegraph or telex between a relatively small number of large banks with well-established correspondent relationships. In many countries the inter-bank transfers were regarded only as acts implementing the instructions of the transferor. Therefore, when the transferee bank acted upon the funds transfer instruction, it was natural to conceive that the transferee bank was honouring the instruction of the transferor, even though the telegram or telex had been sent by the transferor bank or an intermediary bank.

3. The network rules of the various high-value electronic funds transfer networks that have been organized to take advantage of computer-to-computer technology include rules as to when funds transfer transactions made through that network are final. These rules seem to have two main purposes. The first is to protect the settlement. Although this purpose may seem to be of particular significance in regard to net or net-net settlement networks where the unraveling of a settlement would cause immense difficulties, it may in fact be of more importance to a network operated by a correspondent bank, including a central bank. It may be obvious that a net settlement must be irreversible as to all of the participating banks. However, in the absence of rules in the general law of funds transfers as to when a funds transfer transaction becomes irreversible, the transaction might be reversed on the instruction of the transferor. As a result, the correspondent bank might have to reverse the credit to the account of its receiving

bank. This could leave the account with a debit balance that would be unacceptable to the correspondent bank.

4. The second reason for adopting network finality rules is to assure the receiving bank that the credit it has received is irreversible. With that assurance the receiving bank can also give irrevocable credit to its credit party, who may be either the transferee or another bank.

5. The first consequence of the network finality rule is that the sending bank in the fund transfer transaction cannot withdraw its instruction once it is sent through the network. Therefore, the transferor also loses his right to have the instruction withdrawn from the network. However, if the funds transfer has not yet become final in respect of the transferee, the transferor may still have the right to withdraw his instruction in regard to the entire funds transfer. It may therefore be questioned whether the receiving bank in the funds transfer transaction would have an obligation to pass on the notice of withdrawal of the funds transfer instruction. If the receiving bank does not have such an obligation, consideration should be given whether the transferor or transferor bank should have the right to bypass the intermediary banks involved and instruct the transferee bank directly. The question is of particular delicacy because it may arise most often in international funds transfers where the substantive and procedural law of several countries may be involved.

6. Although the problem may arise most often in respect of the withdrawal of a funds transfer instruction on the instruction of the transferor, the same question can arise in respect of notice of the death of the transferor, commencement of insolvency proceedings against him, attachment of his account or other legal proceedings that would interfere with the completion of the funds transfer.

7. If the funds transfer can be stopped by bypassing the receiving bank in the funds transfer transaction and by giving the requisite notice to a later bank in the chain, or directly to the transferee bank, it would seem that a procedure for reimbursing the various banks may need to be established that would also bypass the receiving bank in the funds transfer transaction. If the receiving bank were required to reimburse the sending banks, the funds transfer transaction would not have been final. In this respect a network finality rule is different from some clearing-house rules that provide that a dishonoured cheque may be returned through the clearing-house for a certain period of time after which it can be returned only outside the clearing-house.

8. On the other hand, each funds transfer network must necessarily have a procedure for the return of credit transfer instructions on the request of the transferor bank because of an error it has made or on the initiative of the transferee bank because it cannot execute the instruction, for example, because there is no such account. Since these returns do not seem to disturb the principle of finality of the original funds transfer transaction, perhaps returns arising out of

notices of the type under discussion should also not be considered to disturb the principle of finality of the funds transfer transaction.

9. If the conclusion is reached that finality of a funds transfer transaction between intermediary banks has the effect of blocking notice of these various causes for terminating the funds transfer before the transfer becomes final, the effective result is that, in respect of these matters, the funds transfer becomes final at the same time the funds transfer transaction becomes final.

Issue 34

Should the time of finality of a funds transfer be affected by a guarantee of honour of the funds transfer instruction by the transferor bank?

Reference

"Finality", paras. 41-43

Comment

1. Although guarantee of honour by the transferor bank is usually associated with paper-based debit transfers, such as guaranteed cheques and credit cards, it can also be associated with electronic debit or credit transfers. In particular, any point-of-sale system with delayed debit is likely to guarantee the credit to the transferee (merchant) once the authorization to enter into the transaction has been given to the merchant.

2. One of the immediate consequences of guarantee of honour is to terminate the right of the transferor to withdraw the funds transfer instruction. If the guarantee is considered to be the equivalent of acceptance of a bill of exchange (or certification of a cheque where that is permitted), other consequences associated with finality might also be thought to occur. The subsequent debiting of the transferor's account would not be impeded by the supervening death of the transferor, the commencement of insolvency proceedings, attachment of the transferor's account, set-off by the bank or the transferor's legal incapacity. The underlying obligation might be thought to be discharged upon issue of the guaranteed instruction. It is evident, however, that the transferee would not have a right to availability of the funds until the instruction had been presented for honour or until the time the funds were to be available as provided in the point-of-sale system agreement.

Issue 35

Should there be a specific rule as to whether a transferee bank to which funds have been sent for delivery to the transferee upon identification holds the funds for the transferor or for the transferee?

Reference

"Agreements", para. 4

Comment

1. This issue differs from the general issue of finality of a funds transfer since the funds transfer cannot be completed by crediting the transferee's account. Furthermore, in the majority of cases there is no pre-existing contractual relationship between the transferee and transferee bank directing the bank to hold funds received for the future disposition of the transferee.

2. Although the practice of sending instructions to a bank to pay a sum of money in cash to a specific person upon identification constitutes an extremely small percentage of all funds transfers, it may be worthy of a specific rule. Such transfers are most often sent for small sums through the postal funds transfer system, but bank transfers for significant amounts of money are not infrequent. It is common for the transferee not to present himself over a period of time. This increases the possibility that the transferor may wish to withdraw the funds transfer instruction or that some event such as the transferor's insolvency or legal process against his account may occur before the transferee identifies himself.

3. It may be thought the funds transfer does not become final until the transferee presents himself and claims the cash. In that case the transferee bank would hold the funds at the direction of the transferor and subject to any claims made against assets of the transferor.

4. It may, however, also be thought that once of the transferee bank notified the transferee of the availability of the funds, the transferor would have discharged his obligation to the transferee. Since the transferor would have lost all control over those funds, they would remain at the risk of the transferee. The funds would be treated the same as if they had been deposited to an account of the transferee at that bank.

Issue 36

Should the time when an underlying obligation is discharged by means of a funds transfer be dependent upon the means used by the banks to effect the funds transfer? Should the time of discharge be the same as the time when the funds transfer becomes final?

References

"Finality", paras. 41-43, 92-96.

Issue 35

Comment

1. Especially in large-value transactions, the time when an underlying obligation is discharged by means of a funds transfer may be established by the parties in the underlying agreement. When it is not established by the parties, the relevant legal rules usually establish the time of discharge in relation to the type of funds transfer and the procedures followed by the banks. For this reason, the legal rules on discharge of the under-

lying obligation may be found in the law governing funds transfers, although they may equally well be found in the law governing the underlying obligation.

2. It may be thought that, as the banking practices relevant to funds transfers change, consideration should be given whether the current rules as to when the underlying obligation is discharged continue to be appropriate. The question may be most pertinent in countries where funds transfers have usually been made by cheques and the rules in regard to discharge of an obligation by credit transfer may not be clear. Furthermore, the rules applicable to cheques may not be completely applicable to electronic forms of debit transfer, such as ones made pursuant to a standing authorization to debit.

3. In countries where funds transfers have usually been made by credit transfer, it may be thought that the traditional rules might serve well in the new context. This might particularly be thought to be the case where the underlying obligation is discharged when the funds transfer becomes final, at least if the time of finality of the funds transfer is clear under the relevant law and the current means of making funds transfers. However, where the rules on discharge of the obligation are dependent on a specific action by the bank, perhaps because it is that action which has marked the finality of the funds transfer, it may be thought appropriate to review those rules to determine whether banks continue to take that action or whether some other action by the bank would be more appropriate. Where, for example, the underlying obligation has been discharged when the credit has been entered to the account of the transferee, thought might be given as to when the credit is considered to be entered in the context of batch-processing.

4. There has been a considerable growth in the types of funds transfers where the transferor bank guarantees honour of the instruction. Even though the instruction itself has not as yet been honoured, the addition of the bank's guarantee to the obligation of the transferor may be thought to be sufficient reason to consider the underlying obligation discharged.

Issue 37

Should the rules governing funds transfers take into consideration the possibility that a bank may fail to settle?

Reference

"Finality", paras. 97-99, annex

Comment

1. In countries where there is a distinct possibility that a domestic bank may fail to settle for funds transfers, the legal rules anticipate the need to distribute the loss which arises from such failure. The discussion of system risk indicates that the creation of high-value on-line funds transfer networks has increased that risk in some

countries to the point that new measures have been taken or contemplated.

2. In countries where failure of a domestic bank to settle is considered to be unlikely and where current or future domestic high-value on-line funds transfer networks would not increase the risk, the rules need not necessarily take such possibilities into account. The unexpected occurrence of such an event would have to be handled under rules designed for other purposes, as would the failure of a foreign bank to settle for an international funds transfer.

3. The allocation of the loss between banks arising out of a failure of a bank to settle an international funds transfer might depend upon the law of either of the countries involved. When the failure to settle is of a funds transfer transaction made through an electronic funds transfer network, there may be specific provisions in the network rules to allocate the loss. The loss may also be allocated by application of the rules on finality. These rules may be found either in the law governing funds transfers or in inter-bank agreements.

4. Although inter-bank agreements may affect the rights of the non-bank transferor or transferee by determining the allocation of loss between the banks, those agreements would not be the source for rules determining whether a bank could pass on to its non-bank customer the loss arising out of a failure to settle. However, it is to be expected that if the transferee bank bears the risk that its sending bank will fail to settle, and if this risk is significant, means will be found by the transferee bank not to enter an irrevocable credit to the account of the transferee before settlement is final.

Issue 38

Can a funds transfer become final outside the normal working hours?

Reference

"Finality", paras. 13-14, 32

Comment

1. The banking industry is moving towards a twenty-four hour day for many of its functions, and this may affect the time of day when a funds transfer becomes final. In respect of paper-based funds transfer instructions, it has been common for the data processing flow to be completed after the bank is closed to the public but before personnel go home in the evening. Items received after some cut-off point late in the day have often been considered as having been received the following day and have been processed with that day's activity. Whatever may have been the specific rule on finality, it took effect during normal working hours for the bank's personnel. The practice of completing the act of finality during the normal working hours may have had the character of being a rule of law in some countries.

2. At present, the data processing flow in many banks goes on through the night. In many cases the acts that constitute finality take place outside normal working hours. With customer-activated terminals available in many places on a twenty-four hour basis, funds transfer instructions can be entered at night as well as during the day and, if the system is fully on-line, many of those transactions can be completed immediately. As a result, international funds transfers initiated during the day from a bank in one time zone may be completed during the night in another time zone. This result may also occur in domestic funds transfers made in countries which cross several time zones. It could be expected that the normal operation of the finality rules would lead to the conclusion that these funds transfers had become final at that time. Although this would be a normal result from one point of view, it disturbs the commonly expected pattern that funds transfers are processed and become final during normal working hours.

3. It should also be noted that in those countries where reversal of the debit or credit entries is permitted for a limited period of time, that period for reversal may end outside normal working hours, e.g. at midnight, and the funds transfer would become final at that time.

4. Special problems may arise when an on-line computer-to-computer funds transfer becomes final on one day at the sending bank, but because of the difference in time zones, it becomes final on the previous or following day at the transferee bank.

Issue 39

When should a debit or credit be considered to be entered to an account?

Reference

"Finality", paras. 8, 33, 36

Comment

1. Rules on finality are often based upon the time of entry of the debit or credit to the relevant account, since this was an objective act which seemed to indicate that a decision had been made to honour the instruction and seemed to symbolize the transfer of the claim against the bank from the transferor to the transferee.

2. Modern data processing techniques have reduced the clarity of the act as well as its value as a symbol. Banks often enter the data into the accounts as soon as possible after the funds transfer instructions are received, subject to reversal for a period of time during which the banks can decide whether they wish to honour the instruction. If reversal of an accounting entry is not allowed by law, the entries may be made to a provisional account and only at a later time are the entries in the provisional account merged with the real account. When the instructions are lodged with the bank for action one, two or more days later, they may also be entered immediately into the provisional account,

with indication of their effective date, at which time they are also merged with the real account. These operations were not technically feasible prior to the use of computers.

3. The time of entry of the debit or credit to the account could be considered to be either the time it was entered to the provisional account or the time it was merged with the real account. It may be thought, however, that considering the entry to have been made when it was entered to the provisional account would give that entry a legal value that was specifically intended to be avoided. Furthermore, it seems obvious that the use of a provisional account was intended to give the bank the same opportunity to reverse the entry as is given to banks in countries where the entry is specifically understood to be reversible for a period of time.

4. It may be noted, however, that the two approaches do not give the same result as to the point of time when the debit or credit is entered to the account, or to be more precise, when it becomes final. In legal systems where the entry is reversible for a period of time, it automatically becomes irreversible at the end of that period of time, and the moment is a fixed one. Where the entry of the debit or credit depends on the merger of the provisional account with the real account, entry—and finality—depend upon the act of merging the account. This act can be assumed to consist of a human act to put in motion the computer file up-date. Although this act could be expected to occur at approximately the same time each day, the time might vary for a number of reasons. Of course, the merger could also be notional or, if a file up-date is necessary, it could be set in motion automatically by a clocking mechanism, unless there had been human intervention to delay the merger. All of these possibilities reduce the clarity of the concept of entering the debit or credit to the account.

5. Furthermore, there are difficulties in knowing when batch entries from a computer memory device have been entered to an account. To the extent that entry symbolized a decision to honour the instruction, the entry could better be deemed to have been entered at the time the computer memory device was placed in the machine for processing, or even when it was prepared and ready to be further processed. The point of time when the computer reached a particular item in the batch, even if that moment is recorded by the computer, would seem to have little relevance to the rights of various parties to the instruction or the account.

Issue 40

In what order of priority should the various entries to an account be considered to have been made?

References

"Finality", paras. 32-37
Issues 38-39

Comment

1. When all entries to an account were made by a single individual by hand, the order in which they had been entered was evident and it was rational to base various rules of priority on that order. At present, debit and credit entries arrive from a number of different sources and can be entered to the accounts in different ways. Paper-based items received over the counter or through the mail may be sent to the data processing centre either for entry directly to the account or for entry to a computer memory device that will later be used to enter the items to the accounts. Alternatively, the clerk who receives the item over the counter or opens the mail may key in the data from a terminal at his work station. Instructions may arrive from automated teller machines either on-line or off-line. Although the bank may treat them as identical for the purposes of the interest date, the actual entry to the account may vary by one or more days. Paper-based instructions and electronic instructions that arrive in batches from other banks or clearing-houses may have processing schedules that are independent from the other items processed by the bank. Individual high-value items that arrive by telecommunications may be entered directly to the accounts. Items that are received for processing on a later day may be entered to provisional accounts, and those provisional accounts may be merged with the real accounts at any point of time convenient to the data processing centre.

2. Although it is always possible to establish priorities on the basis of the order in which the debits and credits from the various instructions were entered to the account in question, it may be thought that in the current situation this does not necessarily lead to satisfactory results. It is difficult to know, however, what basis for ranking priority would be better. At least three possibilities which emerge are that the smallest items might be considered to be processed first so that as many as possible can be satisfied, all items might be considered to have the same priority, so that they would share pro-rata, or the bank may be permitted to decide the order in which to enter the items.

3. A network may have a rule that, if a bank fails in the settlement, all credits to that bank remain valid but debits to that bank, i.e. credit transfer instructions sent by that bank or debit transfer instructions received by it, are satisfied in the order in which they passed through the clearing-house. This rule causes no difficulties based on the current discussion if the items pass through the clearing-house as individual items. In fact, it has the advantage of encouraging banks to rely on credit transfer instructions received early in the day and to pass on the credit to their customers, since those instructions will have a high priority in case of the sending bank's failure to settle. However, if settlement is by entry of debits and credits in accounts held with the central bank, or with any other single settlement bank, and items other than those received through the network were submitted to the central bank for debit to the account of the failing bank on the day in question, a decision, similar to that described in paragraph 2,

would have to be made on the priority of the items received through the network for debit to the account of the failing bank as against other items received for debit to that account.

Issue 41

Should a bank have a right to recover an erroneous credit by reversing an entry to the account of the credit party?

Reference

"Finality", paras. 79-80

Comment

1. The most efficient way for a bank to recover an erroneous credit entered to the account of its credit

party is to reverse the entry by debiting the account. This method is particularly efficient if the account is that of the non-bank transferee, with the transferee bank or the *loro* account of the receiving bank held with the sending bank.

2. Reversal of the credit is permissible without question if the credit has not as yet become irrevocable, either because in that country credits may be revoked for a period of time after they are entered to the account or because the credit was entered to a provisional account that has not yet been merged into the real account. However, once the credit has become irrevocable under the relevant law, it may be thought that reversal of an erroneous credit by debit to the account without the prior permission of the credit party should be permitted only with caution. In some countries a transferee bank is permitted to reverse a credit arising out of its own error but not one arising out of an error of the transferor or of the transferor bank.

III. NEW INTERNATIONAL ECONOMIC ORDER: INDUSTRIAL CONTRACTS

A. Sixth session of the Working Group on the New International Economic Order

1. Report of the Working Group on the New International Economic Order on the work of its sixth session (Vienna, 10-20 September 1984) (A/CN.9/259)^a

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Introduction

1. At its eleventh session, the United Nations Commission on International Trade Law decided to include in its work programme a topic entitled "The legal implications of the new international economic order" and established a Working Group to deal with this subject.¹ At its twelfth session, the Commission designated member States of the Working Group.² At its thirteenth session, the Commission decided that the Working Group should be composed of all States

members of the Commission.³ The Working Group consists of the following 36 States: Algeria, Australia, Austria, Brazil, Central African Republic, China, Cuba, Cyprus, Czechoslovakia, Egypt, France, German Democratic Republic, Germany, Federal Republic of, Guatemala, Hungary, India, Iraq, Italy, Japan, Kenya, Mexico, Nigeria, Peru, Philippines, Senegal, Sierra Leone, Singapore, Spain, Sweden, Trinidad and Tobago, Uganda, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United Republic of Tanzania, United States of America and Yugoslavia.

2. At its first session, the Working Group recommended to the Commission for possible inclusion in its programme, *inter alia*, the harmonization, unification

^aFor consideration by the Commission, see *Report*, chapter IV (part one, A, above).

¹Report of the United Nations Commission on International Trade Law on the work of its eleventh session, *Official Records of the General Assembly, Thirty-third Session, Supplement No. 17 (A/33/17)*, para. 71.

²Report of the United Nations Commission on International Trade Law on the work of its twelfth session, *Official Records of the General Assembly, Thirty-fourth Session, Supplement No. 17 (A/34/17)*, para. 100.

³Report of the United Nations Commission on International Trade Law on the work of its thirteenth session, *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17 (A/35/17)*, para. 143.

and review of contractual provisions commonly occurring in international contracts in the field of industrial development.⁴ The Commission at its thirteenth session agreed to accord priority to work related to these contracts and requested the Secretary-General to undertake a study concerning contracts on the supply and construction of large industrial works.⁵

3. The studies⁶ prepared by the secretariat were examined by the Working Group at its second and third sessions.⁷ At its third session, the Working Group requested the secretariat, pursuant to a decision of the Commission at its fourteenth session,⁸ to commence the drafting of a legal guide on contractual provisions relating to contracts for the supply and construction of large industrial works.⁹ The Legal Guide is to identify the legal issues involved in such contracts and to suggest possible solutions to assist parties, in particular from developing countries, in their negotiations.¹⁰

4. At its fourth session, the Working Group examined a draft outline of the structure of the Legal Guide and some sample draft chapters prepared by the secretariat¹¹ and requested the secretariat to proceed expeditiously with the preparation of the Legal Guide.¹² At its fifth session, the Working Group discussed some other draft chapters and a note on the format of the Guide.¹³ There was general agreement that the work on the Legal Guide should proceed as quickly as possible and that two sessions of the Working Group should, whenever feasible, be held every year in order to expedite the work.¹⁴

5. The Working Group held its sixth session at Vienna from 10-20 September 1984. All members of the Working Group were represented with the exception of Algeria, Central African Republic, Cuba, Cyprus, Guatemala, Hungary, India, Nigeria, Senegal, Sierra Leone, Singapore, Trinidad and Tobago, and United Republic of Tanzania.

6. The session was attended by observers from the following States: Argentina, Bulgaria, Canada, Chile, Dominican Republic, Ecuador, Finland, Holy See, Indonesia, Netherlands, Qatar, Republic of Korea, Saudi Arabia, Switzerland, Thailand and Venezuela.

7. The session was also attended by observers from the following international organizations:

(a) *United Nations organs*

United Nations Industrial Development Organization

(b) *Intergovernmental organizations*

Asian-African Legal Consultative Committee
Commission of the European Communities

(c) *International non-governmental organizations*

International Bar Association
International Chamber of Commerce
International Federation of Consulting Engineers
International Progress Organization

8. The Working Group elected the following officers:

Chairman: Leif Sevón (Finland)*

Rapporteur: Jelena Vilus (Yugoslavia)

9. The Working Group had before it for examination eight draft chapters of the Legal Guide on drawing up international contracts for construction of industrial works: "Damages" (A/CN.9/WG.V/WP.11/Add.4), "Liquidated damages and penalty clauses" (A/CN.9/WG.V/WP.11/Add.5), "Scope and quality of works" (A/CN.9/WG.V/WP.13/Add.1), "Completion, acceptance and take-over" (A/CN.9/WG.V/WP.13/Add.2), "Allocation of risk of loss or damage" (A/CN.9/WG.V/WP.13/Add.3), "Insurance" (A/CN.9/WG.V/WP.13/Add.4), "Sub-contracting" (A/CN.9/WG.V/WP.13/Add.5) and "Security for performance" (A/CN.9/WG.V/WP.13/Add.6).

10. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Consideration of draft chapters of the Legal Guide on drawing up international contracts for construction of industrial works.
4. Other business.
5. Adoption of the report.

11. The Working Group proceeded to discuss the draft chapters in the order presented below.

Scope and quality of works¹⁵

12. The general observation was made that the chapter should be re-examined with a view to making it shorter and making the terminology more consistent.

13. It was noted that it would be difficult to include illustrative provisions in this chapter, as the chapter dealt with the scope and quality of works of different kinds, which would require different types of description

⁴A/CN.9/176, para. 31.

⁵See footnote 3.

⁶A/CN.9/WG.V/WP.4 and Add.1-8, and A/CN.9/WG.V/WP.7 and Add.1-6.

⁷A/CN.9/198, paras. 11-80, and A/CN.9/217, paras. 13-129.

⁸Report of the United Nations Commission on International Trade Law on the work of its fourteenth session, *Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17)*, para. 84.

⁹A/CN.9/217, para. 130.

¹⁰See footnote 8.

¹¹A/CN.9/WG.V/WP.9 and Add.1-4.

¹²A/CN.9/234, paras. 51-52.

¹³A/CN.9/WG.V/WP.9/Add.5; A/CN.9/WG.V/WP.11 and Add.1-4 and 6-9.

¹⁴See A/CN.9/247, para. 132.

*The Chairman was elected in his personal capacity.

¹⁵A/CN.9/WG.V/WP.13/Add.1.

of scope and quality. Furthermore, in general, the legal issues dealt with in the chapter were not ones which needed to be clarified through illustrative provisions. It was suggested, however, that the issues dealt with in section E ("Extent of confidentiality of specifications, drawings and other technical documents") might appropriately be the subject of illustrative provisions. It was also suggested that the text might be shortened and clarified by the use of sample forms of some of the types of documents referred to. A further suggestion was that the chapter might include a check-list of the types of documents which might be prepared for the purposes of a contract (e.g. the principal contract document, the invitation to tender, the tender, drawings, specifications, bills of quantities) and that such a check-list might assist the parties to determine which documents should form part of the contract.

14. There was wide agreement that the guide should recommend that the principal contract document should clearly determine which documents relating to scope and quality formed part of the contract. It was suggested that, in view of the large volume of documents which might be prepared by different individuals at different times for the purposes of the contract, the Guide should recommend that the legal advisers of the parties should examine all the documents for the purpose of ensuring consistency and to determine which documents formed part of the contract. It was also suggested that the contract should specify in detail the scope and quality required, since in the absence of such detail the law governing the interpretation of the contract might give it a restricted ambit as regards scope and quality.

15. It was observed that in complex contracts, provisions concerning the scope and quality of construction might be contained in several lengthy documents which were physically separate from the principal contract document. Accordingly, care should be taken to incorporate by reference these separate documents in the main contract documents.

16. The view was expressed that the term "turnkey" did not have a settled meaning under most legal systems and that the obligations imposed on a contractor by the mere use of that term were unclear. It was therefore necessary to elaborate clearly the obligations of the contractor under such a contract. An obligation on the contractor to perform obligations which were usual or necessary, having regard to the intended purpose of the contract, might not be sufficient to identify the contractor's obligations, and the parties should attempt to formulate a more precise description of the residuary obligations of a turnkey contractor.

17. It was noted that defining the scope of construction by reference to a model might lead to difficulties, as the model might be altered, damaged or destroyed, and it would be difficult to ascertain what was contained in the original model. Furthermore, it may be difficult to resolve all issues in a model.

18. It was noted that the term "quality" was used in the chapter in two senses. Firstly, it was used to indicate the nature of materials or services, and secondly, to indicate the level of excellence of the materials or services. It was proposed that in re-drafting the chapter these two senses should be distinguished.

19. There was wide agreement that the use of terms such as "first class" to indicate a level of excellence resulted in uncertainty. It was suggested that descriptions in terms of properties or characteristics of the materials or services in question (e.g. the strength of steel to be used) might be more precise. It was also observed that the words "new and at least of regular commercial quality" appeared to have acquired a degree of settled meaning in commercial practice.

20. The view was expressed that a general description of the nature of materials and services in both the principal contract document and the specifications might lead to inconsistency. Accordingly, it might be preferable to include such descriptions only in the specifications. It was noted, however, that some degree of description of the construction to be effected was necessary in the principal contract document, and that such a description might have to include a brief reference to the level of excellence. There was agreement that while the chapter should describe the various types of specifications, the terms "performance" specifications and "design" specifications should not be used in the chapter.

21. It was observed that the possible relationship between the nature of specifications to be included in invitations to tender, and methods of pricing, was complex, and might be better dealt with in the chapter of the Guide relating to tendering procedures.

22. It was noted that the term "standard" could be understood in one of two meanings. It could refer to legal safety requirements relating to equipment or materials to be supplied, or it could refer to approved descriptions of the characteristics of equipment or materials to be supplied laid down by professional engineering bodies or trade associations. The parties would normally have autonomy in regard to the adoption of the latter type of standards. It was also noted, however, that the country of the purchaser might have its own mandatory standards in respect of works to be constructed in that country.

23. The view was expressed in this connection that the term "applicable law" was ambiguous; it might mean the law applicable to the contract, or the law of the country of the purchaser or the contractor making mandatory the use of certain standards in regard to equipment or materials. The use of the term in the Guide should be clear.

24. It was observed that when agreeing on the use of standards, the standards in question should be clearly identified (e.g. by reference to the country or body

which issued the standard and the date on which the standard was issued). It was also observed that requirements in invitations to tender as to certain standards to be observed by the contractor might have the effect of preventing contractors unfamiliar with these standards from tendering.

25. In respect of inconsistencies between drawings and specifications both supplied by the purchaser, it was noted that when such inconsistencies were brought to his notice the purchaser should be obligated to resolve them within a short period of time. Furthermore, the purchaser should be obligated to bear any costs incurred by the contractor as a result of an inconsistency.

26. In regard to approval by the purchaser of detailed drawings made by the contractor, it was suggested that such approval might not be always needed or be practicable, in view of the frequent changes required during the course of construction. Moreover, in relation to certain techniques of rapid construction (sometimes known as "fast track" construction), the detailed scope of the works, and thus the drawings, were produced and agreed upon as the work progressed. Accordingly, if approval of drawings by the purchaser were to be required, it should be required to be given within a very short time. The purchaser should bear the consequences of delay in giving approval (e.g. bear the resulting costs or grant an extension of time for completion). It was also noted that if the purchaser in fact expressly or impliedly approved detailed drawings, he should not later be entitled to require changes in such drawings or to require changes in construction effected on the basis of such approved drawings.

27. It was observed that drawings might be prepared jointly by the parties, and that the parties should consider how errors in such drawings might be rectified and how the liability should be allocated.

28. It was noted that, if specifications and drawings supplied by the purchaser were inaccurate or insufficient, the purchaser should not only be obligated to pay costs incurred by the contractor as a result of such errors, but also to bear the costs to the contractor of any resulting interruption of performance.

29. The view was expressed that, even when the parties entered into a contract in which the obligations assumed by the contractor had been described in terms of a specified result (e.g. a turnkey contract), the purchaser should have the responsibility for errors (e.g. omission of a part of the construction or requiring the use of unsuitable equipment, materials or services) in specifications and drawings supplied by him. If a purchaser wished to avoid such responsibility, he should obligate the contractor to prepare the specifications and drawings. Alternatively, if the purchaser wished to supply the specifications and drawings, he could obligate the contractor to notify him of errors which the latter discovered or should discover, and the contractor should bear the consequences of a failure to notify.

30. It was agreed that section D ("Hierarchy of documents") should be placed immediately after section B ("Determination of scope and quality of works in contract documents"). It was also suggested that the title of section D might be changed to reflect the changes suggested in the scope of that section.

31. It was observed that the Guide should more clearly emphasize the likelihood of inconsistencies existing between the various documents which comprise a complex contract, and draw attention to the need to make every effort to eliminate such inconsistencies.

32. It was noted that it was difficult to lay down categorical rules as to which of the contract documents was to prevail in case of inconsistency. While from the standpoint of a lawyer it might be preferable for specifications which were in the text of the main contract to prevail over drawings which consisted of diagrams, an engineer might prefer the opposite result. There was wide agreement that several factors might be relevant to determining which document was to prevail (e.g. which document embodied the later agreement of the parties, the nature of the conflict between the documents, or which document principally focused on the issue in question). It might be preferable to recommend that the documents should in the first instance be construed as mutually explanatory, and in case of irreconcilable conflict that the matter be referred to an expeditious form of dispute settlement.

33. There was wide agreement that the problems relating to the confidentiality of specifications, drawings and other technical documents needed more extensive treatment. It was suggested that three distinct concepts, i.e. ownership, copyright and confidentiality, needed to be considered in relation to such documents.

34. The view was expressed that the concept of confidentiality might give rise to several difficulties. The parties should be encouraged to identify clearly the documents which they wished to remain confidential, the extent of the confidentiality desired, and the duration of the confidentiality. It was noted that mandatory laws might regulate the extent to which confidentiality might be accorded, and also obligate the parties to disclose the contents of documents to public authorities in the country of the purchaser or the contractor. Difficulties might also arise in relation to the clause on confidentiality if the contract was terminated, or if the purchaser later wished to employ another contractor to modify or improve the works, or if confidential documents needed to be disclosed in legal proceedings between the parties. The parties should also be advised to provide for the remedies which the aggrieved party should have in the event of a breach of confidentiality.

35. It was agreed that, after the re-drafting of the text of the chapter, the summary should be re-examined to ensure consistency between the text and the summary.

Completion, acceptance and take-over¹⁶

36. The view was expressed that the concepts of completion and acceptance should be modified. Completion might be considered to occur when the contractor performed his obligation to construct the works and mechanical completion tests were successfully conducted. The concept of acceptance might include the approval by the purchaser of construction of the works, even if this approval was in certain situations only deemed to be given.

37. It was suggested that the terminology used in the chapter should be made more consistent, and that the sequence in which tests, completion, take-over and acceptance occurred should be made more evident. A suggestion was made that the discussion of mechanical completion tests, now contained in the chapter "inspection and tests", might be moved to this chapter.

38. It was noted that in construction practice, take-over of the works usually followed completion, and that acceptance usually occurred after a successful trial operation of the works. It was suggested that the draft chapter, and in particular paragraph 1, should be redrafted so as to reflect this practice.

39. A question was raised as to whether it was advisable to distinguish between take-over and acceptance. The prevailing view was that such a distinction was desirable, since take-over and acceptance might occur at different times and might have different consequences.

40. A suggestion was made that paragraph 4 should be re-drafted so as to make it clear that the period of time for completion of construction might commence to run when all of the relevant events referred to in that paragraph had occurred. According to an additional suggestion, subparagraph (d) of paragraph 4 should be modified to suggest that the period of time for completion of construction might commence to run on the date on which the purchaser delivered to the contractor a design, drawings or descriptive documents of adequate quality.

41. The view was expressed that the importance of the time for completion and the time-schedule should be stressed in the Guide, and that the parties should be advised to settle these issues in the contract itself, and not to postpone agreement on them until after the contract had been concluded. It was suggested that the purchaser might be entitled to order the contractor to speed up construction if it appeared that a deadline might not be met. It was further suggested that the purchaser might establish milestone dates for achieving progress in the course of the construction, but that the contractor should establish the construction schedules for meeting those milestone dates. The contractor should be liable only for delay in meeting the milestone dates and for additional costs incurred by the purchaser as a result of the delay. According to a further

suggestion, the time for completion might be subjected to a condition, and, if the condition occurred, the rules governing the providing of an extension of time for performance in the case of an exempting impediment might be made applicable. A suggestion was made that the method of calculating the extension of time for completion discussed in paragraph 14 should be dealt with in detail.

42. A view was expressed that section B, 3, dealing with extension of the time for completion, should be deleted since the situations in which such extension should occur were dealt with in other chapters. However, the prevailing view was that it was advisable to retain these paragraphs in this chapter since the chapter might be read independently of the others. A suggestion was made that the discussion of the time schedule (section B, 2) should be located in another chapter.

43. A suggestion was made that the grounds for extension of time for completion discussed in paragraph 12 (b) should not be limited to administrative regulations issued after the conclusion of the contract. A view was expressed that in all the cases described in paragraph 12 an extension of time should automatically be available to the contractor, if he wanted one. It was also suggested that paragraph 13 should be deleted or brought into harmony with the treatment of this subject in the chapter "Liquidated damages and penalty clauses".

44. A view was expressed that the parties should agree upon a special mechanism to facilitate the quick settlement of disputes concerning the time for completion and the time schedule, as well as disputes concerning the results of performance tests.

45. According to one view, the Guide should deal with the consequences of extension of time for performance on insurance, security interests and costs. According to another view, these issues should not be discussed in this chapter; however, reference might be made to the chapters dealing with these issues.

46. A view was expressed that the last sentence of paragraph 18 should deal not only with delay but also with the costs which might be incurred in connection therewith.

47. It was suggested that the Guide might advise that a protocol reflecting the condition of the works should be signed at the time of completion of the works.

48. Differing views were expressed concerning the consequences of delay for which the purchaser was responsible in the conduct of mechanical completion tests. According to one view, in such a case completion should be presumed to have occurred, and the guarantee period should commence to run. According to another view, the only consequence should be that the purchaser should be liable to compensate the contractor for losses incurred by the contractor as a result of the delay.

¹⁶A/CN.9/WG.V/WP.13/Add.2.

49. A view was expressed that consideration should be given to harmonizing the statement in paragraph 17 that mechanical completion tests might be considered successful even if certain items are found to be missing, and the statement in paragraph 20 that performance tests might be considered successful if the works are found to be free of serious defects. It was suggested that it would not be advisable to indicate that the purchaser might authorize the carrying out of performance tests before mechanical completion tests.

50. The importance of formalities connected with the conduct of mechanical completion or performance tests, and the necessity to comply with such formalities in some cases, was stressed. It was suggested to distinguish between the participation in such tests of an inspecting organization chosen by the parties and inspection by a regulatory organization under mandatory legal rules, which was necessary in some countries before putting the works into operation.

51. It was noted that supply of some documentation (e.g. operation and maintenance manuals) by the contractor should be required by the stage of mechanical completion or performance tests. The expression in paragraph 19 "to prove in any other manner" was considered to be too vague, and the Guide should attempt to envisage other possible methods of proof.

52. It was suggested that this chapter should deal with provisional acceptance. The view was expressed that the chapter should discourage the use of provisional acceptance, unless the contract specified when it occurred and what consequences it had. It was noted that in practice the term "provisional acceptance" was sometimes used as a substitute for the term "take-over".

53. Various views were expressed concerning the consequences of a failure to conduct performance tests. According to one view, such a failure should result in presumed acceptance. Under another view, the consequences should be more limited. It was suggested that the contract should provide a time-limit within which performance tests had to be conducted, and should also provide for the consequences of a failure to conduct the tests within that period.

54. It was suggested that the Guide should indicate what an acceptance protocol should contain and that including an illustrative form of a protocol might be useful. It was observed that it might be useful to distinguish between acceptance by the purchaser unilaterally, and the execution by both parties of an acceptance protocol, which might contain the agreement of the parties as to missing items to be supplied and defects to be cured.

55. It was pointed out that presumed acceptance might occur in certain cases in addition to those where performance tests could not be conducted due to reasons for which the purchaser was responsible. In addition to the consequences of acceptance mentioned in paragraphs 29 to 31, the Guide might deal with the consequences of acceptance on such matters as security

for performance, insurance and payment of the price. It was suggested to mention in paragraph 31 that a guarantee period should commence to run in respect of a portion of the works when that portion was accepted by the purchaser.

56. It was agreed to deal in this chapter only with take-over of the plant during construction and the completed works, and not with take-over of equipment and materials prior to their incorporation in the works. It was noted that the term "possession" in the definition of take-over might be interpreted in different ways under various legal systems. It was suggested that the terms "physical possession" or "control" might be used. In respect of the delivery of equipment and materials, it was recommended to use the terminology of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980).

57. It was suggested to redraft paragraph 36 so as to avoid the interpretation that the contractor had an obligation to give all instructions to the purchaser's personnel needed for the operation of the works. It was noted that the allocation of costs during the trial operation period need not always follow the principle indicated in paragraph 36. A view was expressed that the responsibility of the contractor during the trial operation period might depend on whether the purchaser's personnel were to be trained by the contractor.

58. The view was expressed that the title of section D, 1,c, should refer to termination of the contract by the purchaser due to a failure to perform by the contractor. It was suggested to avoid reference in paragraph 37 to the concept of partial termination of the contract. It was also suggested to deal with the consequences of termination upon guarantees either in the chapter "termination" or in the chapter where the guarantee was discussed.

59. It was suggested to redraft paragraph 38 so as to suggest that if the purchaser chose the remedy mentioned in this paragraph, take-over might occur. It was also suggested to make reference to the chapters on "Failure to perform" and "Passing of risk".

60. It was suggested that a take-over protocol might not be needed in cases where acceptance occurred and take-over took place immediately thereafter. It was also suggested that the discussion of the take-over protocol should be expanded.

61. It was pointed out that, since paragraphs 40 to 41 did not deal with take-over of the plant during construction or the completed works, the issues discussed in those paragraphs should be discussed in other chapters.

62. Various suggestions were made for improving the drafting of this chapter. It was agreed that a redrafted chapter should be examined by the Working Group at an early date and that the terminology should then be re-examined.

Allocation of risk of loss or damage¹⁷

63. It was agreed that the present title of this chapter ("Allocation of risk of loss or damage") should be changed to "Passing of risk". The general observation was made that the drafting of the chapter might be improved, and specific suggestions for improvement were brought to the attention of the secretariat. The view was expressed that the chapter should deal only with loss of or damage to equipment, materials, the plant during construction and the completed works caused by accidental events or by the acts of third persons for whom neither party to the contract was responsible. It was noted, however, that it might be useful to refer in this chapter to other chapters of the Guide dealing with loss of or damage to equipment, materials, the plant during construction or the completed works caused by a party, or third persons for whom a party was responsible. The view was expressed that the chapter should point out that whoever would be held responsible for the risk of loss or damage should have the right to control the situation which could give rise to such loss or damage.

64. It was suggested that in section A ("General remarks"), the first sentence of paragraph 3 should be deleted, and that instead the paragraph should indicate that often the rules as to the passing of risk in many legal systems were formulated with reference to sales contracts and did not necessarily envisage some of the special problems arising in relation to works contracts. It was also suggested that section A should indicate that, under the recommendations made in this chapter, the time of the passing of risk in respect of equipment, materials, the plant during construction or the completed works might not coincide in some cases with the time of the transfer of property.

65. The view was expressed that the discussion in this chapter of the relationship between the passing of risk and liability for defective performance was unclear and should be omitted. Issues relating to liability for defective performance should be dealt with in the chapter on "Failure to perform".

66. It was suggested that paragraph 8 should be redrafted to clarify that it dealt with the issue of the passing of risk and did not relate to the effect of exempting impediments. The distinction drawn between these two issues in paragraph 2 should be more clearly formulated. The view was also expressed that all the events mentioned in paragraph 8 were not in practice excluded by the parties from the risk of loss or damage borne by the contractor, and that the paragraph should be modified accordingly.

67. It was suggested that this section should include a paragraph dealing with the interrelationship of the passing of risk to connected issues dealt with in other chapters, such as insurance and the transfer of property. It was also suggested that consideration might be given to a change in the sequence of some of the paragraphs in this section, as this might facilitate understanding.

68. The view was expressed that the chapter should indicate the interrelationship between the bearing of risk in respect of equipment and materials supplied by the contractor for incorporation in the works (section B) and the bearing of risk in respect of the plant during construction and the completed works (section D). It was noted that the relevance of the presence of the contractor's personnel on the site at the time of the supply of equipment and materials to the passing of risk in respect of such equipment and materials should be reconsidered. It was observed that it was sometimes difficult to provide for the passing of risk at a time when it was possible to check the condition of the equipment and materials, and it was also observed that provision for the passing of risk at the time when the customs formalities were concluded at the frontier of the country from which the equipment and materials were exported was not often found in practice.

69. It was suggested that the need for rules on the passing of risk for works contracts which were different from the rules for sales contracts should be emphasized, since the obligations of a contractor under a works contract were not performed by mere delivery of equipment and materials, but by the use of such equipment and materials for the purposes of construction. The contractor should therefore generally bear the risk of loss of or damage to equipment and materials.

70. It was observed that it might be useful to clarify the notion of "incorporation" of equipment and materials in the works, and in particular to clarify the point of time at which such incorporation occurred. It was also observed that the approach set forth in paragraph 15 (a) to (c) providing for the risk to pass at specified times, and the approach set forth in paragraph 16 for a determination of the passing of risk by reference to INCOTERMS, were not in substance different approaches but were different methods of formulating the same approach.

71. Different views were expressed concerning the identity of the person who should bear the risk of loss of or damage to the plant when several contractors were engaged for the construction. Under one view, it was practicable for each separate contractor to bear the risk in respect of the portion constructed by him. Under another view, at least when a portion of the plant was being constructed by the use of equipment and materials supplied by one contractor and services supplied by another contractor, this approach was not practicable, and the purchaser should bear the risk. It was suggested that in most cases the time of take-over of the works should be the relevant time for the passing of risk, and not the time of acceptance.

72. The question was raised whether the issues discussed in section E ("Consequences of bearing of risk") should be dealt with in another chapter. The prevailing view, however, was that these issues should be dealt with in this chapter.

73. The obligation of a party who bore the risk in respect of property to make good loss or damage

¹⁷A/CN.9/WG.V/WP.13/Add.3.

covered by the risk was considered. There was wide support for the suggestion that, if so requested by the purchaser, the contractor should be obliged to make good, at the expense of the purchaser, loss of or damage to property the risk of which was borne by the purchaser. Reservations were expressed, however, as to whether the purchaser should in such cases be obliged to make good such loss or damage if he did not request the contractor to do so. In this connection, the view was expressed that the meaning of the term "to make good" should be clarified. It was also suggested that the obligation of the purchaser to pay the price for property lost or damaged in respect of which he bore the risk should be emphasized. It was noted that, while section E suggested that the obligation of the contractor to make good loss of or damage to property the risk of which was borne by the purchaser should end with the expiry of the guarantee period, another possible approach was to make that obligation end upon take-over or acceptance of the works by the purchaser.

74. It was suggested that no distinction should be made in respect of the period of time within which the loss or damage was to be made good, as between the party who bore the risk and the other party. Whichever party was under the contract obliged to make good the loss or damage should be obliged to do so with all possible speed. It was also suggested that reference should be made to a right to use damaged but serviceable equipment pending its repair or replacement.

75. It was suggested that the last two sentences in paragraph 25 should be deleted, as the issue dealt with therein did not primarily relate to the passing of risk.

Damages¹⁸

76. It was suggested that this chapter should contain a discussion of the relationship between damages and other remedies, such as liquidated damages and penalties and other forms of compensation which might be payable by a party. This discussion should refer to the availability of such remedies in situations in which there was a breach of contract as well as in situations in which there was no breach.

77. A suggestion was made that the chapter should refer to the types of losses which the parties should take into consideration in drafting contractual provisions on damages. Various views were expressed in respect of the types of losses which should be compensated by damages. According to one view, only those types of losses which were specified in the contract should be compensated. It was suggested that the word "all" in the first sentence of paragraph 5 should be deleted. According to another view, the contract should provide for all losses to be compensated by damages, except those expressly excluded by the contract. A suggestion was made that the Guide should indicate that the aggrieved party might not be reasonably compensated if there were too many provisions in the contract limiting

the right to damages. It was noted that the extent of the damages for which the contractor could be liable under the contract could have an impact on the contract price. It was suggested that the Guide should advise parties that in drafting contractual provisions on damages they should take into consideration rules of national law concerning damages. It was suggested that as one possible approach the parties might wish to rely on such rules of national law, except to the extent that these rules were not suitable for the particular contract. In the latter event, the contract might set forth different rules, unless the rules of national law were mandatory.

78. There was wide support for the principle that a party who fails to perform an obligation under the contract should be liable for damages unless the failure was due to an exempting impediment. It was suggested that the parties might wish to agree upon the situations in which no damages were to be paid. The view was expressed, however, that it might be possible to draft such a contractual provision only in terms which were too general. It was agreed that the illustrative provision contained in footnote 2 should be deleted.

79. Various approaches were discussed concerning the situations in which the aggrieved party should be liable to pay compensation to a third party due to a breach of contract by the other party. It was agreed that paragraph 7 should be deleted.

80. It was noted that the mitigation by the aggrieved party of his losses might be regulated by mandatory rules of national law. It was suggested that such mitigation should be treated as an obligation of the aggrieved party, and not as a limitation of damages. It was also suggested, however, that the determination of the types of losses to be compensated by damages, discussed in paragraphs 5 to 8, might have the effect of limiting damages, and that the chapter should be restructured accordingly. An additional suggestion was made that paragraph 11 and footnote 3 should be re-drafted so as to avoid an interpretation that if a party took steps to mitigate his losses all of his losses would be compensable by damages.

81. The question was raised as to whether the concept of unforeseeability of losses referred to the types or amount of such losses. Various approaches were discussed in respect of the time which should be relevant for determining foreseeability. It was suggested that the Guide should bring such approaches to the attention of the parties. A suggestion was made that the parties might agree to inform each other of changes in circumstances which might influence the extent of damages in the event of a breach. It was noted that if the time of the breach of contract were the relevant time for determining foreseeability, it might be difficult to ascertain the time of such a breach in cases other than delay.

82. Various views were exchanged with respect to indirect and consequential losses. It was stressed that the concepts of such losses differed under various legal systems. A suggestion was made that the last two

¹⁸A/CN.9/WG.V/WP.11/Add.4.

sentences in paragraph 14 should be deleted. It was also suggested that the Guide should contain an illustrative provision dealing with indirect or consequential losses.

83. It was noted that in most works contracts the amount of damages recoverable by a party in the event of a breach by the other party was limited, and that this practice should be reflected either in paragraph 15 or in the section on general remarks. It was noted that under national and international legal rules the liability of a carrier of goods was limited as to amount. It was suggested that the parties should be advised to take such rules into account in drafting provisions of the contract on limitation of damages. It was also noted that in practice damages were sometimes limited to the amount recovered through insurance, or to such an amount plus a percentage of the price, and there was agreement that the Guide should bring these approaches to the attention of the parties.

84. It was suggested that the last section of the chapter, concerning personal injury and damage to the property of third persons, should deal with contractual responsibility for such injury and damage. However, it was noted that under some legal systems mandatory rules of law might limit the internal allocation of responsibility for such injury and damage between the parties. It was noted that, while the contract could not restrict the liability of the contractor or the purchaser to compensate third persons for such injury and damage, under some legal systems third persons could benefit from contractual provisions expanding their rights to receive such compensation. A suggestion was made that the Guide should discuss joint and several responsibilities of the contractor and the purchaser for personal injury and damage to the property of third persons. It was suggested that the requirement under paragraph 18 that the purchaser notify the contractor of a claim by a third person should be limited to cases where the purchaser intended to involve the contractor in the negotiations or legal proceedings concerning such a claim.

Liquidated damages and penalty clauses¹⁹

85. It was suggested that at the commencement of the chapter attention should be directed to the fact that under most legal systems there were mandatory rules governing liquidated damages and penalty clauses and that, accordingly, the choice of the law governing the contract was of great significance in relation to such clauses.

86. The view was expressed that the relationship between the chapter "Damages" and this chapter should be examined. It was noted that both chapters related to compensation payable on failure of performance, and that the issue of limitation of liability was relevant to both chapters. In this connection it was suggested that the Guide should contain a section examining the inter-relationship of damages, and liqui-

dated damages and penalties, and the respective emphasis which the parties might wish to give to these remedies.

87. It was observed that the payment of a bonus was an effective way of stimulating performance, and that this chapter should contain a reference to the chapter dealing with clauses providing for the payment of a bonus.

88. It was noted that under some legal systems the term penalty meant an agreed sum payable on failure of performance by a party, which was intended to coerce that party to perform, while under other legal systems the term had a wider meaning and included agreed sums having purely compensatory objectives. Whenever the term was used in the Guide, the sense in which it was being used should be clear.

89. It was observed that provisional liquidated damages clauses were sometimes used in practice, and that this usage should be noted in the Guide. Under such a clause, an agreed sum was payable by a party upon a failure of performance. The clause further provided, however, that even if the failure of performance occurred and the sum was paid, it was to be repaid to the party paying it if that party was subsequently able to prevent loss from being caused by that failure of performance.

90. The view was expressed that the purpose of liquidated damages and penalty clauses described in paragraph 2 (b) of the chapter needed clarification.

91. It was emphasized that the Guide should concentrate on its primary purpose of assisting parties to draft a contract. Accordingly, while the Guide might draw the attention of parties to differing rules in legal systems relating to liquidated damages and penalty clauses which they should consider in drafting such clauses, it was unnecessary for the Guide to describe the justifications for these rules. It was also inadvisable for the Guide to refer to normal rules of interpretation, as rules of interpretation might differ in different legal systems. In this connection, the view was expressed that the Guide should not state that, when an agreed sum was provided for defective performance other than delay, the purchaser could claim both the agreed sum and performance, as under some legal systems this was not permitted.

92. There was wide agreement with the statement in the chapter that under many legal systems, as a condition for liquidated damages or a penalty to become due, there must not only be the specified failure of performance but there must also be liability for such failure of performance. There was general agreement that a liquidated damages or penalty clause which might provide for payment by a contractor of liquidated damages or a penalty, even if the contractor's failure of performance was caused by the purchaser, would be manifestly unfair and unacceptable. Different views were expressed, however, as to a possible statement in the Guide that the parties may wish to provide that

¹⁹A/CN.9/WG.V/WP.11/Add.5.

liquidated damages or a penalty were to be payable by a contractor even if his failure of performance was due to an exempting impediment. Under one view, such a provision was not encountered in practice and was unfair to the contractor. Under another view, examples of such provisions were in fact found in practice, and such provisions might not be unfair in respect of certain types of exempting impediments. Furthermore, since the issue in question related to which of two innocent parties was to bear the risk of loss caused by an exempting impediment, parties should be free to agree to allocate the risk to one or the other party. It was agreed that the Guide should indicate that in exceptional cases one might find provisions under which a party was obliged to pay liquidated damages or a penalty although not otherwise liable for the consequences of a failure of performance.

93. It was suggested that section C of the chapter ("Increasing effectiveness of liquidated damages and penalty clauses") might more appropriately be entitled "How to increase the effectiveness of liquidated damages and penalty clauses". It was also suggested that an attempt should be made to make paragraph 9 more concise and clear.

94. In regard to section D ("Ceiling on recovery of agreed sum"), it was agreed that in the context of liquidated damages and penalty clauses the term "ceiling" might have more than one significance, and that an attempt should be made to use clear terminology. As regards paragraph 14, it was observed that two approaches to limitation of recovery were referred to therein and needed to be distinguished. The first approach was for the contract to provide that when liquidated damages or penalties were fixed by way of increments (e.g. a fixed amount being due per unit of delay) and a limit was placed beyond which the increments could not increase, no further recovery of any kind was possible after that limit was reached. Another approach was that, while no recovery of liquidated damages or penalties was possible after the limit was reached, it would be possible for the purchaser after the limit was reached to affirmatively prove that additional loss was suffered and to recover damages for such additional loss.

95. It was noted that section E ("Obtaining agreed sum") suggested the possibility of formulating contractual provisions under which the purchaser could recover liquidated damages or a penalty from a contractor by way of deduction from sums due from the purchaser to the contractor. It was observed that under some legal systems and in some countries the issue of deduction was regulated by mandatory rules and other requirements. It was also observed that the rules under some legal systems were such as to make provisions as to deduction of the kind suggested impracticable. For example, a court might have a mandatory power to reduce a sum agreed as a penalty, so that a deduction of an agreed sum might be later invalidated if a court reduced the agreed sum. It was noted, on the other hand, that provisions as to deduction were workable under other legal systems. It

was agreed that the attention of the parties should be directed to the need to formulate provisions for deduction after consideration of the relevant legal rules and other requirements.

96. It was suggested that, even where provisions as to deduction were workable under the applicable law, the Guide should describe such provisions as a possible approach. It was also observed that consideration should be given to placing in another chapter (e.g. in the chapter on "Security for performance") the technique, mentioned in section E, of enhancing the certainty of recovery of the agreed sum through the opening of a guarantee.

97. The view was expressed that the possibility addressed in paragraph 16, i.e. the date from which the commencement of delay was to be calculated becoming inoperative by reason of certain circumstances, and the consequences of such a possibility, i.e. the inability to apply a liquidated damages or penalty clause for delay, should be more clearly formulated. It was also noted that while, as stated in paragraph 16, the contractor would in these circumstances under some legal systems be bound to perform within a reasonable time, this may not be the result under other legal systems.

98. The view was expressed that section G ("Termination of contract and liquidated damages and penalty clauses") should be restricted to advice as to the drafting of a provision regulating the effect of termination on a liquidated damages or penalty clause, and that issues such as the right to recover damages after termination should be dealt with in the chapter "Termination". It was also suggested that the language and structure of the section might be reconsidered with a view to achieving simplification.

99. There was agreement that this chapter should not only draw the attention of the parties to the "Uniform rules on contract clauses for an agreed sum due upon failure of performance" adopted by the Commission at its sixteenth session,²⁰ but should also indicate that the rules might be used as a basis for resolving the often difficult issues which arose in drafting liquidated damages and penalty clauses.

Insurance²¹

100. The view was expressed that the chapter should reflect a greater balance with respect to the provision of insurance by the contractor and the purchaser, respectively. In addition, a view was expressed that, due to the wide variety of contracts to which the Legal Guide was to apply, the chapter should avoid stating how particular issues concerning insurance should be resolved in the contract; rather, the chapter should draw the attention of the parties to possible approaches which they might consider with respect to these issues.

²⁰Report of the United Nations Commission on International Trade Law on the work of its sixteenth session, *Official Records of the General Assembly, Thirty-eighth Session, Supplement No. 17 (A/38/17)*, annex I.

²¹A/CN.9/WG.V/WP.13/Add.4.

101. It was suggested that the chapter should discuss the various types of risks which often existed in connection with the construction of industrial works. A view was expressed that the parties should be advised to make themselves aware of the types of insurance which were available and the risks which could be insured against, as well as risks which were usually excluded from insurance coverage. Suggestions were made that the chapter might contain illustrative provisions with respect to the insurance to be provided. A further view was expressed that the parties should be advised that it might not be possible to insure against all risks, and that the cost of insurance against certain risks might be excessive by reason of the magnitude of these risks. A view was expressed that the parties should be advised to consider who should bear risks which could not be covered by insurance. Further suggestions were made that the chapter should point out some of the reasons why the purchaser had an interest in the contractor having insurance coverage for risks which were to be borne by the contractor, but the insurance of which was in any event ultimately to be paid by the purchaser.

102. It was suggested that the purchaser should be advised that at the pre-tender stage it would be desirable for him to consult with an international insurance broker or risk management consultant as to what insurance was available in the market, and what insurance should be required in the contract. It was also suggested that the purchaser should be advised to consider whether it would be less expensive for him to provide certain types of insurance himself, rather than require the contractor to do so. Additional views suggested that the chapter might refer to the possibilities of self-insurance and partial self-insurance by the contractor, to political risk insurance and to wrap-up insurance. According to other views, however, these possibilities should not be discussed in the chapter.

103. The view was expressed that the chapter should refer to the desirability of naming both the contractor and the purchaser as insured parties in insurance policies in order to avoid the difficulties and costs associated with the subrogation of the insurer against the party not named. It was suggested that the chapter should discuss reasons why the purchaser might have an interest in having the contract require insurance against risks and liabilities borne by the contractor.

104. A view was expressed that the chapter should recommend that insurance be taken out with an insurer who had the financial capacity to insure the risks and who was acceptable to both parties. According to an additional view, the chapter should discuss the advantages and disadvantages of taking out as much of the insurance as possible with a single insurer, as opposed to several insurers. A view was further expressed that it would be desirable for the chapter to discuss means of adjusting the amount of insurance provided in order to take account of inflation. A further view was expressed that the parties should be advised to require insurance proceeds to be payable in a freely convertible or a specified currency (e.g. the currency in which the contract price was expressed).

105. With respect to insurance of the completed works, a view was expressed that the parties should be advised to consider whether this insurance should be required throughout the guarantee period. A view was expressed that when several contractors participated in the construction, it was advisable for each contractor to insure the portion of the plant during construction and completed works for which he was responsible. According to an additional view, one of several contractors should not be obligated to insure the plant and works in its entirety if he merely co-ordinated construction by the other contractors.

106. With respect to insurance of equipment and materials to be incorporated in the works, a view was expressed that the purchaser's interest in having such insurance in force began not earlier than the time when such items were shipped. It was also noted that in practice, equipment and materials in transit to the site were insured under a separate transport insurance policy. If there arose a dispute whether loss or damage occurred to equipment or materials during the transport period or during another period, under current practice the insurers covering these periods would bear equally the payment of compensation for the loss or damage. A suggestion was further made that the chapter should advise the parties that each of them should be insured with respect to loss of or damage to equipment and materials in respect of which he bore the risk of such loss or damage.

107. With respect to insurance of the contractor's equipment and tools, the view was expressed that such insurance was usually of interest only to the contractor. A suggestion was made to advise the parties to consider whether it was necessary for the contract to require such insurance; if so, the cost thereof should be borne by the contractor. It was further suggested that the chapter should take note of the difficulties which might be involved if a foreign contractor were required to take out such insurance with an insurer in the country of the purchaser.

108. With respect to liability insurance, a suggestion was made that the chapter should specify the periods of time during which the various types of such insurance should be in effect. In this regard, a view was expressed that the period of coverage of products liability insurance should be linked to the applicable legal limitation or prescription period.

109. A suggestion was also made that the parties should be advised that professional indemnity insurance might not be available to a contractor who both designed and constructed the works.

110. A view was expressed that the chapter should deal with the advisability or necessity for each of the parties to provide insurance to compensate for injury to workmen. According to an additional view, the parties should be advised to require such insurance particularly in respect of workmen from the country where the works was being constructed.

111. With regard to proof of insurance, a view was expressed that the contract should set a time-limit by which such proof was to be provided by the contractor to the purchaser. Another view was that the contract should also obligate the purchaser to provide proof to the contractor of insurance required to be taken out by the purchaser. A suggestion was made that the contract should authorize one party to receive proof of insurance from an insurer providing insurance for the other party. In addition, a suggestion was made that the contract should obligate a party to instruct an insurer from whom he had obtained insurance to notify the other party if a premium was not paid.

112. According to one view, the contract should be terminable by the purchaser if the contractor failed to provide insurance which he was required to provide. According to another view, the contract should not be terminable in such a case, and the purchaser's remedy should be to claim damages for any loss suffered by him as a result of the failure.

113. A view was expressed that if the contract entitled the purchaser to purchase at the contractor's expense insurance which the contractor was obligated but failed to provide, the contract should obligate the purchaser to give to the contractor advance notice of his intention to purchase the insurance. According to an additional view, the contractor should be responsible only for reasonable expenses incurred by the purchaser in obtaining such insurance.

Sub-contracting²²

114. It was suggested that the chapter should recommend that the parties pay special attention to provisions on sub-contracting when negotiating and drafting their works contract, since unsatisfactory treatment of this issue could result in problems with the construction and the quality of the works. A view was expressed that the scope of the term "sub-contracting" as used in the chapter should be clarified so as to differentiate those entities which were included in the term from those which were not. For example, sub-contractors should be distinguished from suppliers.

115. The existence of a legal relationship between the purchaser and a sub-contractor was discussed. According to one view, no legal relationship should exist between these entities. According to another view, such an approach was too absolute. In support of the latter view, it was suggested that under some legal systems a legal relationship between the purchaser and a sub-contractor might exist in respect of particular issues. For example, a purchaser could claim directly against a sub-contractor for a breach of certain obligations. Under other legal systems, there existed a tripartite relationship among the contractor, purchaser and sub-contractor. A legal relationship between the purchaser and a sub-contractor might also arise in some cases from certain provisions of the contract, such as those

permitting a purchaser to select or to participate in the selection of a sub-contractor, those permitting the purchaser to claim directly against the contractor, and those permitting the purchaser to pay a sub-contractor directly.

116. Views were expressed concerning the liability of the contractor to the purchaser for acts and omissions of a sub-contractor. It was suggested that various approaches to this issue should be brought to the attention of the parties. According to one approach, the contractor should be fully liable to the purchaser for the acts or omissions of a sub-contractor. According to another approach, the liability of a contractor to the purchaser for the acts or omissions of a sub-contractor should be reduced or excluded if the contractor did not freely select the sub-contractor.

117. A view was expressed that the contract should authorize direct communications between a sub-contractor and the purchaser only as to technical matters or matters relating to the design or quality of the works. According to a further view, the settlement of such matters between the purchaser and a sub-contractor should be effective only if it did not affect obligations of the contractor which were not to be performed by the sub-contractor. Moreover, under this view communications which were not authorized by the contract should result in the contractor's not being liable for acts taken pursuant to such communications. Suggestions were made that the contractor should have the right to be present at discussions between the purchaser and a sub-contractor, and that the contract should obligate the purchaser to inform the contractor of any communications between the purchaser and a sub-contractor. It was also suggested that the chapter should refer to the need of a sub-contractor to receive information in certain situations from the purchaser.

118. Suggestions were made that the chapter should deal with the substitution of one sub-contractor for another, with consortia which were sub-contractors and with sub-sub-contracting. It was suggested that paragraph 3 of illustrative provision 1 should be contained in a general provision of indemnity of the purchaser by the contractor.

119. With respect to the right of the contractor to sub-contract, various approaches were proposed for inclusion in the chapter. According to one approach, the contractor should be able to sub-contract freely. According to another approach, the right of the contractor to sub-contract should be restricted, and the discussion in paragraphs 7 and 8 of the chapter was appropriate in this regard. A suggestion was made that the contractor should not be permitted to sub-contract a major portion of the works. It was noted that it might be difficult for the contract to specify which obligations of the contractor could not be sub-contracted. There was a suggestion that it would, therefore, be preferable for the contract to prohibit sub-contracting of the contractor's obligations, except those obligations which the contract specified could be sub-contracted by the contractor. It was also noted that in practice the sub-contracting of design obligations was often prohibited.

²²A/CN.9/WG.V/WP.13/Add.5.

120. The selection of sub-contractors was discussed. A suggestion was made that the three approaches to this issue referred to in the chapter should be more clearly delineated. It was also suggested that the chapter should discuss all three approaches and indicate the advantages and disadvantages of each approach.

121. The view was expressed that the parties should be advised that, whenever possible, the sub-contractors should be named in the works contract. The view was also expressed that the parties should be advised that it was undesirable to provide for sub-contractors to be chosen by the contractor subject to the approval of the purchaser after the conclusion of the contract. According to this view, this approach was dangerous in works contracts, since if the purchaser objected to a sub-contractor it might not be possible to propose another sub-contractor. Moreover, this approach could result in an interruption of the work. Under the same approach, it was noted that if the purchaser controlled the sub-contracting he would have to pay any extra price incurred as a result.

122. A suggestion was made that where the sub-contractor was to be chosen by the contractor subject to the approval of the purchaser after the conclusion of the contract, the contractor should be obligated to give a copy of the sub-contract to the purchaser together with any other information in relation to the proposed sub-contracting which the purchaser might require. It was noted, however, that it might not always be possible for the contractor to inform the purchaser of the sub-contract price.

123. It was also suggested that in the cases referred to in the previous paragraph the contractor should consult with the purchaser and obtain his opinion and, subject to his approval, provide the materials referred to.

124. It was noted that the circumstances giving the purchaser an interest in the selection of a sub-contractor, referred to in paragraph 11, would exist in all cases, even in cases in which the purchaser did not participate in the selection of a sub-contractor. In addition, these circumstances also applied to the contractor.

125. It was suggested that the chapter should emphasize the importance of co-operation and communication between the parties, regardless of which approach was chosen with respect to the selection of sub-contractors. A suggestion was made that the terms of the main contract should be included in the sub-contract to ensure that the sub-contractor was bound to comply with the standards of the main contract. It was also suggested that the parties should be advised to provide a mechanism to resolve expeditiously disputes concerning the selection of sub-contractors.

126. It was agreed that the chapter should deal with the nomination system as one mechanism which the parties might consider for the selection of sub-contractors. However, the use of the nomination system

should not be encouraged, and the dangers in the use of the system should be pointed out. It was suggested, for example, that under some legal systems it might be possible in some cases for a nominated sub-contractor with whom the purchaser had negotiated to claim that an agreement had been reached between the purchaser and the sub-contractor. In such a case the purchaser might be held liable to the nominated sub-contractor if the nominated sub-contractor was not engaged by the contractor. In addition, the purchaser might have to bear loss or damage arising from defective performance by a nominated sub-contractor. According to another view, the nomination system was satisfactory as long as the contractor was given the right to object to a sub-contractor nominated by the purchaser. The reasons given in paragraph 24 were emphasized, including the fact that national legislation might at times require the use of local sub-contractors.

127. With respect to the grounds upon which the contractor should be able to object to a sub-contractor nominated by the purchaser, it was suggested that in addition to the grounds discussed in paragraph 22, reference should be made to the fact that due to trade policies of his own country, the contractor might be able to sub-contract only with sub-contractors from certain countries. It was also suggested that the contractor should be able to object to a nominated sub-contractor if the latter was not sufficiently qualified to perform the work or was unable to indemnify the contractor fully for loss or damage arising out of the sub-contractor's acts or omissions. As a possible method of dealing with the ground referred to in paragraph 22 (a) (i.e. a failure by the sub-contractor to undertake towards the contractor liabilities comparable to those imposed on the contractor towards the purchaser), it was suggested that the damages payable by the contractor to the purchaser might be limited to the damages that the contractor was able to recover from the nominated sub-contractor. According to another view, however, this method was not satisfactory; it did not resolve the situation in which the contractor incurred liability to a third person as a result of acts or omissions of the sub-contractor, and the sub-contractor did not sufficiently indemnify the contractor against such liability. In such a situation, the liability of the contractor to the third person could not be reduced by the works contract.

128. A view was expressed that the responsibility of the contractor for the acts or omissions of a nominated sub-contractor, referred to in paragraph 24, was one of the approaches which should be dealt with in the chapter. According to another view, however, while that approach might be referred to in the chapter, it should not be endorsed. It was suggested that the chapter should also discuss the approach whereby the purchaser bore responsibility for the acts and omissions of a nominated sub-contractor. A view was also expressed that if the contractor failed without good reason to engage a nominated sub-contractor, he should be liable to the purchaser for any losses arising from this failure.

129. Different views were expressed concerning the liability of a contractor if a nominated sub-contractor abandoned the sub-contract or the sub-contract was terminated. Under one view the purchaser should bear the losses and expenses associated with the interruption of the work and the engagement of a new sub-contractor in cases where the contractor was not at fault. Accordingly, it was suggested that the last two sentences of paragraph 25 should be deleted. According to another view, however, the solution contained in these sentences was satisfactory if the parties agreed to it.

130. It was suggested that the chapter should point out that, as a possible means to resolve the problems arising under the nomination system, the purchaser might wish to engage the sub-contractor himself.

131. Various approaches were proposed to enable the purchaser to claim directly against the sub-contractor in respect of certain matters, such as obligations of confidentiality and guarantee obligations. Under one approach, guarantee obligations would be imposed on the sub-contractor by the sub-contract; under another approach, the contractor may assign all his guarantee rights against the sub-contractor to the purchaser and in this case the contractor should no longer be responsible to the purchaser. The same obligations would be imposed on the contractor in the works contract. Under some legal systems, the purchaser would then be able to bring a claim against the sub-contractor in the name of the contractor for a breach of such obligations. Under another approach, the purchaser, contractor and sub-contractor would become parties to a tripartite agreement containing such obligations. Under yet another approach, the question of direct claims by the purchaser against a sub-contractor would be settled by national law.

132. With respect to the question of determining when direct payments by the purchaser to a sub-contractor might be justified, it was suggested that the contract might provide that as a condition to receiving progress payments from the purchaser, the contractor would be obligated to provide the purchaser with proof that previous payments by the purchaser to the contractor in respect of sub-contracted work had been applied to the sub-contractor. In the absence of such proof, or a satisfactory explanation why such previous payments had not been applied to the sub-contractor, the purchaser could pay the sub-contractor directly and deduct such payment from the amount due to the contractor. It was noted, however, that the ability of the purchaser to pay a sub-contractor directly and to deduct such sums from amounts due to the contractor might impair relations between the purchaser and the contractor. The view was expressed that the purchaser should be informed that this mechanism might lead to great risk and might involve the purchaser in disputes between the contractor and sub-contractors. It was pointed out in particular that the purchaser should beware lest he pay the sub-contractor too much. A suggestion was made that the last sentence of paragraph 30 should be reconsidered in the light of the question whether the situation envisaged in that sentence could occur in practice.

Security for performance²³

133. The view was expressed that the chapter should emphasize the expenses which might be entailed in different arrangements for the provision of guarantees. Parties may consider whether, in view of the reputation and financial standing of a contractor, minimal guarantees might be sufficient. Where guarantees had to be provided, the chapter should advise that the comparative costs of different arrangements should be examined with a view to avoiding unnecessary expense. It was noted in particular that an arrangement under which a monetary performance guarantee was given by one bank and confirmed by another might entail considerable expense.

134. It was observed that references in the chapter to other texts should be limited. Where relevant information or contractual arrangements were contained in other texts, it was preferable to set forth that information or those arrangements in the chapter itself. If other documents were referred to, they should be texts which had in some manner been accepted by the Commission.

135. Differing views were expressed as to how widely guarantees, and in particular performance guarantees, were used in contracting practice. Under one view, such guarantees were insisted on by purchasers in only a few regions, while under another view they were required in many regions and were always required when a works contract was financed by funds from an international development institution.

136. A view was expressed that the description of a tender guarantee contained in paragraph 5 might not accord with the way in which such guarantees operated in practice. It was also suggested that the terminology used in the chapter should be clear and consistent. Thus, possible confusion between a performance guarantee and a quality guarantee relating to performance should be avoided. Furthermore, it was noted that the term "performance guarantee" was used in the chapter to denote two different types of guarantee (distinguished in the chapter as "monetary performance guarantee" and "performance bond"). Accordingly, whenever the term "performance guarantee" was used, the sense in which it was being used should be clarified. It was also suggested that the presentation in the chapter might be improved if monetary performance guarantees and performance bonds were dealt with separately.

137. As regards the choice of guarantors, a view was expressed that the parties should be encouraged to agree on the guarantors to be provided before the conclusion of the contract. If there was no such choice before the conclusion of the contract, and the purchaser thereafter rejected the guarantor chosen by the contractor, the contractor might find it difficult to find another guarantor acceptable to the purchaser. A view was expressed that for the adequate protection of the

²³A/CN.9/WG.V/WP.13/Add.6.

purchaser it might not be necessary to insist on a guarantor from the purchaser's country, but that a guarantee from a first-class bank or other financial institution, possibly from a country which was neither that of the purchaser or the contractor, might be sufficient. A view was expressed in this connection that, even if the purchaser insisted on a guarantee from a bank in his country, in practice that bank might sometimes obtain a counter-guarantee from a foreign bank in order to ensure that sufficient convertible currency was available to satisfy the possible payment obligations under the guarantee. It was also noted that the parties should examine whether the guarantor had the financial capacity to satisfy the obligations included in the guarantee. It was suggested that the chapter should indicate that in some cases a governmental guarantee might be requested by the purchaser to support the obligations undertaken by the contractor.

138. The view was expressed that while the terms "independent" and "accessory" guarantees were often used, the terms "conditional" and "unconditional" guarantees were also used, and that this latter usage might also be mentioned in the chapter. The view was expressed that the use of the term "independent" should be reconsidered.

139. It was observed that, in addition to the possible arrangements relating to recourse under first demand guarantees discussed in the chapter, the chapter might describe other possible arrangements which might help to protect the interests of both the purchaser and the contractor. One possible arrangement was for the guarantee to provide that the guarantor was not obliged to pay the purchaser immediately on demand, but only after the lapse of a specified period. The lapse of time enabled negotiations to take place between the purchaser and the contractor with a view to settling the dispute between them. Another possible arrangement was for the guarantor to pay the money on demand by the purchaser into the hands of a third party, who could hold it in trust pending resolution of the dispute between the purchaser and the contractor. It might also be possible in the works contract to provide that the purchaser must give notice to the contractor before making a demand for payment, or must give the contractor a period to cure the alleged defects before making a demand. A failure to observe these contractual terms would expose the purchaser to contractual liability to the contractor. In addition, if such contractual terms were provided, courts in some legal systems might prevent the purchaser from claiming under the guarantee in breach of these terms.

140. A view was expressed that, even when the guarantee in question was a first demand guarantee, the guarantor might not in all cases be obliged to pay on the bare assertion of the purchaser that there had been a failure of performance by the contractor. The chapter might indicate that some jurisdictions had developed certain very limited restrictions on the right of recourse of the purchaser (e.g. when the claim was made fraudulently). It was also noted that it might be helpful to distinguish clearly between the relationship between

the purchaser and the guarantor and the relationship between the purchaser and the contractor. While an unfair call under a first demand guarantee would oblige the guarantor to pay, the rights of the contractor against the purchaser for breach of contractual provisions relating to the call of the guarantee would remain unimpaired.

141. In regard to the last sentence of paragraph 18, the view was expressed that, while the parties usually did have a common interest in the successful completion of the contract, nevertheless in certain circumstances this might not be sufficient to discourage an abuse of rights under a first demand guarantee. Accordingly, there was agreement that this sentence should be deleted.

142. The view was expressed that the suggestion in the chapter that the purchaser might stipulate in his invitation to tender the guarantors whom he would be prepared to accept should be clarified. One possibility would be for the purchaser to stipulate the identity of the guarantors whom he would be prepared to accept. However, since many contractors might be unable to secure the named guarantors, it might be desirable to stipulate only acceptable types of guarantors (e.g. those providing monetary performance guarantees or those providing performance bonds). A view was also expressed that requiring a tender to be accompanied by a certificate from a prospective guarantor indicating his willingness to give a performance guarantee might not be a useful approach, as under some legal systems the undertaking in the certificate would not be enforceable.

143. It was noted that the chapter suggested in paragraph 19 that, when the guarantee was to be furnished after the conclusion of the contract, the parties should agree on the right of the purchaser to recover damages in case the guarantee was not furnished. It was observed, however, that in respect of this remedy the purchaser should carefully consider the likely value to him of such unsecured rights to damages against a foreign contractor, the amount of damages which might actually be suffered by him, and the possible difficulties involved in obtaining an award against the foreign contractor.

144. It was noted that the relevant currency for payment under both a repayment guarantee and a performance guarantee (paragraph 20) would usually be the currency in which the contract price was to be paid. It was also noted that the reference in paragraph 23 to a liability of the guarantor to pay for costs and damages suffered by the purchaser was unnecessary, since the purchaser would in practice claim a global sum under the guarantee and was not bound to prove that he had suffered costs or damages.

145. A suggestion was made that a reference be given in section B, 2 ("Security for performance created through payment conditions") to the chapter "Price", which would contain a detailed treatment of payment conditions.

146. A view was expressed that paragraph 36 did not sufficiently reflect current practice in some regions with regard to the release to the contractor of sums outstanding from the full contract price. It was noted that the payment conditions often provided that fifty per cent of the sum outstanding was to be released upon completion of the works, and that the balance fifty per cent was to be released upon expiry of the guarantee period.

147. It was suggested that it would be useful to indicate the conditions under which it might be appropriate for a contract to require both the provision of security for performance by a contractor through guarantees, and security created through payment conditions, or to require only one form of security. It was also suggested that, when both forms of security had been provided, the chapter should address the question of the options which might be open to the purchaser in relation to enforcement of the securities.

148. It was observed that section C ("Security for payment by purchaser") might be re-examined to ensure a balance between that section and section B ("Security for performance by contractor"). In particular, the chapter should note in paragraph 39 that it might be preferable for the contractor to have the letter of credit in his favour opened by a bank in his country and that, in addition to exchange control difficulties, the contractor might face other administrative difficulties in obtaining payment. Furthermore, as an alternative to requiring a revolving letter of credit, as noted in paragraph 40, attention should be directed to the opening of a letter of credit in the amount of the full contract price. It was noted that the objective of a better balance might be achieved by a greater emphasis in section C on alternative approaches which might be adopted, rather than on specific recommendations.

149. It was noted that the mere fact that the works was financed by an international lending agency or other reputable institution might not be a sufficient assurance of payment to the contractor. Under certain contractual arrangements, payments were due only upon certification of due performance of work by an engineer who was an employee of the purchaser or pursuant to authorization by the purchaser. Circumstances might therefore occur in which certification which was appropriate did not occur and the financial institution was unable to make payment. A method of resolving this difficulty might be for the right of the contractor to obtain payment to be activated by a procedure which was independent of the purchaser.

150. It was observed that the parties might wish to provide for the consequences which were to follow if the purchaser failed or delayed to open the letter of credit as required under the contract. It was also observed that section C should describe the deferred payment system sometimes adopted in the financing of works contracts, under which credit for the construction was granted by or on behalf of the contractor and the

purchaser undertook to make deferred payment during a period of time agreed between the parties.

151. It was suggested that a reference might be made to the methods of dispute settlement which might be adopted when disputes arose both with regard to the security to be provided by the contractor for the performance of his obligations and with regard to the security to be provided by the purchaser for the payment of the price.

152. There was general agreement that security interests in property (section D) was not of great importance to either party as a means of securing due performance by the other party. It was noted that the subject was complex and difficult to describe concisely. It was observed that security interests in favour of the purchaser over the construction machinery of the contractor had declined in importance, as such machinery was often leased by the contractor and not owned by him. It was agreed that the subject did not merit treatment in a separate section of the chapter, but that the contents of the present section dealing with this subject might be noted at appropriate points in other sections of the chapter. A view was expressed, however, that the chapter might also refer to retention of title and mortgages. A view was also expressed that the parties should be reminded that it would be desirable to obtain independent legal advice on the applicable law relating to security in property that was located in another country.

Other business and future work

153. It was noted that two further sessions of the Working Group might be needed to complete the deliberations on most of the draft chapters to be contained in the Legal Guide. Several draft chapters would be prepared for the next session of the Working Group, which would be held, in accordance with the decision of the Commission, from 8 to 19 April 1985, in New York.²⁴

154. The Secretary of the Commission stated that the secretariat would submit to the seventh session of the Working Group a revision of the draft outline of the structure of the Legal Guide (A/CN.9/WG.V/WP.9/Add.1) and that this revision would reflect the deliberations of the Working Group and would contain some re-arrangement and amalgamation of certain chapters as the secretariat might consider appropriate. The secretariat would also submit to the eighth session of the Working Group the redrafted chapters "Completion, acceptance and take-over" and "Choice of contract type", since the original draft chapters required substantial revision in the light of the discussion by the Working Group.

²⁴Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17 (A/39/17)*, para. 154.

2. Draft Legal Guide on drawing up international contracts for construction of industrial works: draft chapters: report of the Secretary-General (A/CN.9/WG.V/WP.13 and Add.1-6)

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[A/CN.9/WG.V/WP.13]

Introduction

1. At its second session, the Working Group on the New International Economic Order decided to request the secretariat to commence the preparation of a legal guide on contracts for the supply and construction of large industrial works.¹ The Commission at its fourteenth session approved this decision by the Working Group and decided that the Guide should identify the legal issues involved in such contracts and suggest possible solutions to assist parties, in particular from developing countries, in their negotiations.²

2. After having completed at its second³ and third⁴ sessions the consideration of a study submitted by the secretariat of clauses used in contracts for the supply and construction of large industrial works,⁵ the Working Group at its third session requested the secretariat to submit to the Working Group an outline of the structure of the Guide and some sample draft chapters.

3. At its fourth session the Working Group discussed the outline of the structure of the Guide and the draft chapters "Choice of contract type", "Exemptions" and "Hardship clauses".⁶ There was general agreement that the structure of the Guide was on the whole acceptable. It was also generally recognized that, as the work progressed, some rearrangement of the structure might become necessary, and the secretariat was given the discretion to make such rearrangement. The contents of the draft chapters were also considered to be generally acceptable, and suggestions were made for improving them.

4. At its fifth session, the Working Group discussed the draft chapters "Termination",⁷ "Inspection and tests", "Failure to perform",⁸ "Variation clauses",

"Assignment" and "Suspension of construction" as well as a note on the format of the Guide.⁹ Suggestions were made for improving the draft chapters and the illustrative provisions contained therein. Some general observations were exchanged on the draft chapter "Damages",¹⁰ and consideration of this draft chapter and the draft chapter "Liquidated damages and penalty clauses"¹¹ was postponed to the sixth session.

5. The present report contains in its addenda six draft chapters prepared by the secretariat: "Scope and quality of works", Add.1; "Completion, acceptance and take-over", Add.2; "Allocation of risk of loss or damage" (previously referred to as "Passing of risks"), Add.3; "Insurance", Add.4; "Sub-contracting", Add.5 and "Security for performance", Add.6.

[A/CN.9/WG.V/WP.13/Add.1]

Scope and quality of works

Summary

The contract should describe accurately and in detail the works to be constructed, and in particular its scope and quality. For this purpose, contract practice has developed special contract documents (paragraph 1). The main documents in which the scope and quality are described are the principal contract document, specifications, and drawings. Other documents, such as those listing standards to be applied in the construction, may also be used (paragraph 3). The parties should determine which of the documents dealing with the scope and quality of the works form part of the contract (paragraph 4).

The basic description of the scope of construction to be effected should be set forth in the principal contract document (paragraph 5). This document should also define the main types of performance expected from the contractor (e.g. design, civil engineering), and the major items of construction to be performed (e.g. manufacture of generators) (paragraphs 5-6). In a turnkey contract, the contractor may be obligated to effect all construction which is usual, or which is necessary, having regard to the intended purpose of the works (paragraph 8).

¹A/CN.9/198, para. 92.

²Report of the United Nations Commission on International Trade Law on the work of its fourteenth session, *Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17)*, para. 84.

³A/CN.9/198.

⁴A/CN.9/217.

⁵A/CN.9/WG.V/WP.4 and Add.1-8, A/CN.9/WG.V/WP.7 and Add.1-6.

⁶A/CN.9/WG.V/WP.9 and Add.1-4.

⁷A/CN.9/WG.V/WP.9/Add.5.

⁸A/CN.9/WG.V/WP.11/Add.1-3.

⁹A/CN.9/WG.V/WP.11/Add.6-9.

¹⁰A/CN.9/WG.V/WP.11/Add.4.

¹¹A/CN.9/WG.V/WP.11/Add.5.

The specifications and drawings together should contain full information on quality, and a full technical description of the works to be constructed. Certain information may be more appropriately conveyed through specifications, and other information through drawings (paragraph 10).

Specifications may describe from a technical standpoint the required quality of the equipment, materials and services to be used for the construction (so-called "design" specifications). Alternatively, the specifications may describe from a technical standpoint the required performance of the finished product, without describing in detail how this performance is to be achieved (so-called "performance" specifications) (paragraph 12). Specifications may list the sections of the work covered by the specifications (paragraph 13). The extent of detail contained in specifications will vary. For example, "design" specifications will contain detailed descriptions (paragraph 14) as will specifications for building work (paragraph 15).

The drafting of specifications may be facilitated by the use of standards prepared by professional bodies. Such standards define the characteristics of certain equipment or materials. The use of such standards gives an assurance of quality through uniform testing and inspection procedures. The standards to be used should be familiar to the purchaser (paragraphs 17-19).

Drawings show in diagrammatic form the various component parts of the works. Drawings may be supplied by the purchaser or his consulting engineer (paragraph 20). The contract may obligate the contractor to bring to the notice of the purchaser any inconsistency he may discover between such specifications and drawings (paragraph 21). Where the contract provides for the purchaser to supply basic drawings and for the contractor to prepare detailed drawings on the basis of these basic drawings, the contract should contain a mechanism to ensure that the detailed drawings conform to the basic drawings (paragraph 22).

The contract should address the issue of responsibility for inaccurate or insufficient specifications and drawings. In principle, the party who supplies inaccurate or insufficient specifications and drawings should be responsible for the data contained therein (paragraphs 23-24). In some cases, an ancillary part of the construction may be omitted from specifications and drawings supplied by the purchaser. If the construction obligations of the contractor have been defined in terms of achieving a certain result, and not limited by reference to the drawings and specifications, the contractor would be responsible for achieving the result (paragraph 25).

The parties should determine which of the several documents relating to the scope and quality of the works is to prevail in the event of an inconsistency. In principle, the principal contract document should prevail over other documents. In respect of specifications and drawings, the decision as to which should prevail may depend on the aspect of the construction involved (paragraph 27).

The contract should determine the extent of confidentiality of the information contained in technical documents prepared by a party for the purposes of the construction and delivered to the other party. The parties may wish to provide that in general the party who prepares the documents retains the ownership in them. The documents may be used for the purposes for which they are intended, but should not be disclosed to a third person without the other party's consent. In certain circumstances, however, the purchaser may have an interest in obtaining ownership in technical documents prepared by the contractor (paragraphs 28-29).

* * *

A. General remarks

1. In works contracts it is of great importance to describe precisely the subject-matter of the contract, which is usually a combination of civil engineering, building, the manufacture, delivery, and erection of equipment, and the supply of materials. The description must be, on the one hand, broad enough to encompass the scope of the whole works (purpose, capacity and other main characteristics) and, on the other hand, detailed enough to define the quality and other characteristics of the technical details. In order to achieve this, contract practice has developed special descriptive methods and a special system of contract documents.

2. The contractual arrangements in each case will determine the parties who have to supply the various contract documents. If the purchaser solicits bids for the construction of the works, he must attach to his invitation to tender documents which describe the works to be constructed. If a licensor is to supply a process to be utilized in the works, he must supply the documents which will enable the contractor to construct that part of the works relating to the utilization of the process. Under a turnkey contract, the purchaser may only indicate the main features and operational capabilities of the works which he desires to be constructed, and the contractor will be obliged to supply the specifications and drawings defining the quality of the works.

B. Determination of scope and quality of works in contract documents

3. The scope and quality of the works are usually reflected in several types of documents. The principal contract document will contain a basic description of the works to be constructed, and may contain general statements as to the quality of the works. Technical details of the works to be constructed, its quality, and how exactly the construction is to be effected are contained in contract documents usually entitled "specifications" and "drawings". Provisions describing the quality of equipment, materials and services are contained in specifications, and depictions of the intended use of equipment, materials and services are contained in drawings. In some contracts, particularly when civil engineering and building work is involved, there is

often another type of document (sometimes referred to as a "bill of quantities") which contains further details of the scope of the work to be performed. Other documents may also be relevant to determining the scope and quality of the work, such as lists of standards to be observed in the construction.

4. Some of the documents mentioned above focus primarily on legal obligations, while others focus on technical standards and engineering details. Nevertheless, all these documents are legally important because they together contractually determine the scope and quality of the works. The parties should clearly determine which of the documents dealing with the scope and quality of the works form part of the works contract. Such a determination may be advisable, as the rules of the applicable law determining the documents which form part of a contract may be inappropriate to a works contract.

C. *Description of works*

1. *Scope of construction*

5. The basic description of the construction to be effected under a works contract should be set forth at the beginning of the principal contract document. This document should also define the main types of performance expected from the contractor, such as the supply of equipment, design, fabrication, installation, testing and delivery of mechanical and electrical components, transportation, civil engineering, building and maintenance.

6. The parties should in addition set forth in the principal contract document a more detailed enumeration of the major items of construction to be performed, such as the manufacture or supply of generators, turbines, structures for housing turbines, or kilns, or the construction of administrative buildings. Such a more detailed enumeration may also set forth the basic engineering characteristics of the enumerated items.

7. The principal contract document should include an account of the conditions under which the capacity and operational capability of the works is expected to be achieved. In some works contracts, a precise description of such conditions (for example, the power load needed or the specific mix of raw materials which should constitute the input) may be very lengthy, and it may not be practical to include it fully in the principal contract document. In such cases, the description of such conditions contained in other documents should be clearly linked to the basic description contained in the principal contract document.

8. The basic description of the works may be complemented, in particular in a turnkey contract, by an additional provision obligating the contractor to effect all construction which, although not specifically described, is nevertheless usual or necessary, having regard to the intended purpose of the works. The mere use of the term "turnkey" to describe the contract may

not be sufficient to impose such an obligation on the contractor, since the term may not under some legal systems have a settled meaning. Such a provision will avoid disputes as to who should bear the costs of small items of material or work either forgotten during the negotiations or not considered worthy of special mention.

9. The description of what is to be done by the contractor may be followed by an enumeration of equipment or materials to be supplied or building or civil engineering to be effected by others, in cases where the purchaser or other contractors also participate in the construction. Although, from the legal point of view, it is unnecessary to enumerate items of work not to be performed by a contractor, such a negative enumeration often makes for certainty. The parties may also sometimes wish to use a model of the works or a portion of the works to be constructed in order to define the scope of the construction to be effected.

2. *Quality of works*

10. The parties should ascertain that the specifications and drawings together contain full information as to quality, full instructions on how equipment, materials and services are to be related, and the complete technical requirements of the work. When bids are solicited, the specifications and drawings together should be sufficiently detailed to enable a bidder to prepare a priced tender. No clear rules may be formulated as to what information should be conveyed through the drawings and what information should be conveyed through the specifications. The nature of the two types of documents, however, influences their content. What can be better expressed graphically and through drawings should not be included in specifications, which consist of descriptive writing. Thus, for example, a whole structure may be shown in drawings without an attempt to indicate the different materials to be used for its construction. A breakdown of the component parts of the structure, and the properties of the different materials to be used for construction, may be set forth in the specifications.

(a) *General descriptions*

11. The parties may include in the principal contract document a provision setting a general standard of quality for the equipment, materials and services to be used in the construction of the works. Such a provision may state that all equipment and materials to be incorporated in the works, and services to be supplied, should be "first class", "most suitable", or "the best quality". Such a clause may protect the purchaser where some specific quality has not been provided for in the specifications. Such general descriptions of quality, however, are capable of differing interpretations, and accordingly it is desirable that the contract should also contain very specific quality requirements for the variety of equipment, materials and services to be used in the construction.

(b) *Specifications*

12. The specifications may themselves contain data on the quality of materials and services and instructions on how these are to be applied and combined in order to achieve the results shown in the drawings, or they may simply describe in technical language the required performance of the finished product without describing in detail how this performance is to be achieved. In the latter case the specifications are often called "performance" specifications, while in the former case they are often called "design" specifications. The specifications may also contain other data describing the work (e.g. dimensions). Specifications will usually have general provisions and special technical provisions. The parties should make certain that the documents containing the specifications form part of the contract.

13. The general provisions in specifications, while being similar in content to the general descriptions in the principal contract document, should be more elaborate. No guidelines can be laid down for the drafting of these provisions applicable in all cases. However, the generally technical nature of specifications will result in their containing more technical data and being more technically precise and elaborate than the descriptive provisions of the principal contract document. Specifications in their general provisions should list the sections of the work covered by the specifications. In some instances, the parties may find it useful to set forth in the specifications requirements concerning specific methods of work to be adopted by the contractor, or a special sequence in the construction (required, for example, by an unusual condition of the site). In practice, information concerning such matters as the availability of storage space for the contractor's equipment and materials or the availability of power, water, or other utilities, is sometimes given in the specifications.

14. "Design" specifications should contain a detailed technical description of each item of the work. Such specifications should describe the types and kinds of materials to be provided for each item, their physical and performance properties, the sizes and dimensions of each item of work, the manufacturing techniques to be applied, and any other information of a technical nature relating to the quality of the construction to be effected.

15. Specifications differ for various types of work. Specifications for building may need to be more detailed than for civil engineering due to the multitude of smaller items contained in a building project. Both building and civil engineering specifications will generally be "design" specifications. On the other hand, in specifications for equipment, where the emphasis is likely to be on the performance of the equipment, the specifications will necessarily have to leave considerable latitude to contractors in selecting the proper design, manufacturing techniques and materials to achieve the required performance. The type of contract to be entered into may also influence the degree of detail required. If an invitation to tender solicits bids on a lump-sum basis, very detailed specifications may be needed.

16. The parties should determine how the specifications may most accurately describe the quality of materials to be used. In some cases, the quality may have to be defined in terms of outward appearance, while in other cases it may have to be defined in terms of physical or chemical properties. The contract may prescribe various inspection requirements and testing or approval procedures in order to secure the quality of the specified materials (see chapter XIII, "Inspection and tests"). When any of these procedures are to be conducted at the premises of the contractor, the contract should stipulate the facilities (e.g. laboratory facilities) to be afforded by the contractor for this purpose.

(c) *Standards*

17. The drafting of specifications may be facilitated by the use of various standards, e.g. for equipment and materials. Standards for equipment and materials are regularly issued and perfected by various professional engineering bodies, industrial associations and governmental authorities. Where the contract provides for the use of a standard, the source of the standard and the means of ascertaining the requirements of the standard should be specified.

18. Some standards have become internationally accepted and are widely used in international tendering and contracting. Such standards may relate to matters such as the quality, contents, dimensions, form, weight, composition, packing, and testing of certain equipment or materials. As a rule, the use of such standards is advisable because the standards give tested and verified criteria in respect of the matters which they regulate, and provide an assurance of quality through uniform testing and inspection procedures. Parties should also ascertain whether, under the applicable law, the observance of certain standards is mandatory.

19. The parties should ensure that the standards are appropriate for the type of works being constructed. The use of inadequate standards may lead to defects in the works. The parties should also ascertain whether the standards to be used are familiar in the purchaser's country. The use of unfamiliar standards may reduce the possibility of employing sub-contractors from the purchaser's country or using local materials.

(d) *Drawings*

20. The drawings show in diagrammatic form the various component parts of the works, and in some cases the appearance of the whole works. In cases where the purchaser or his consulting engineer is responsible for supplying the drawings, it may often occur that drawings supplied by the purchaser prior to tendering will not be sufficient for the execution of the construction, and that further drawings become necessary. In such cases the purchaser should, after the conclusion of the contract, from time to time supply further and more detailed drawings. Such further

drawings should be consistent with earlier drawings, as otherwise the contractor may claim that he is being required to effect construction not provided for in the contract.

21. The parties may wish to obligate the contractor to bring to the notice of the purchaser any inconsistency he may discover between drawings and specifications supplied by the purchaser. Such a provision is intended to give the purchaser the opportunity to decide whether the drawings or the specifications are to be followed by the contractor. The contract should therefore entitle the purchaser to determine this question and should obligate the contractor to perform in accordance with the purchaser's determination.

22. In some cases, although the purchaser supplies basic drawings, the contractor is obligated to provide detailed or "shop" drawings. Such drawings are a detailed elaboration of the ideas already contained in the basic drawings provided by the purchaser. The contract should provide that such detailed drawings which the contractor produces should not contain any deviations from the basic drawings. In order to maintain proper control over the work of the contractor, the contract should also provide that the contractor is obliged to submit all detailed drawings for the approval of the purchaser. The contract may, however, provide that approval of the detailed drawings, or the absence of objection by the purchaser to such drawings, should not be deemed to be consent by the purchaser to changes from the basic drawings. If such provision is made, the contract should entitle the purchaser to require corrections to be made to such detailed drawings so as to make them accord with the basic drawings, and to require that any work already done on the basis of the inconsistent detailed drawings should be re-executed so as to conform to the basic drawings.

3. *Responsibility for inaccurate or insufficient specifications and drawings*

23. In cases where specifications and drawings are to be furnished by the purchaser, contractors should be obligated to analyse the information contained in the specifications and drawings, and if they find that such information is inaccurate or insufficient, to suggest modification. However, the purchaser should be responsible for the inaccuracy or insufficiency, and all corrections and changes necessitated by such errors may be considered as variations ordered by the purchaser. He should be obligated to pay all costs incurred by the contractor as a result of such corrections and changes (see the chapter, "Variation clauses").

24. If specifications and drawings are to be supplied by the contractor, he should bear the costs occasioned by all corrections and changes necessitated by inaccurate or insufficient specifications and drawings. Moreover, if such corrections and changes cause a delay in the contractor's performance, he should also be liable for such delay.

25. Cases may arise when an ancillary portion of the construction has been omitted from the specifications and drawings. If the error was made by the contractor, he should be responsible for the omission. If the error was made by the purchaser, the consequences may depend upon the nature of the works contract. If the construction obligations assumed by the contractor have been primarily defined in terms of a specified result (for example, as in a turnkey contract), the contractor should be liable if he does not achieve the result even if a portion of the construction needed for this result had been omitted from the specifications and drawings. If, however, the obligations assumed by the contractor have been primarily limited to the specifications and drawings (for example, to supply and erect certain equipment described in the specifications and drawings), his obligations would be limited by those documents, and the costs resulting from the error should be borne by the purchaser.

26. Disputes may also arise when the use of specified equipment, materials or services is required by the purchaser in certain specifications and drawings furnished by him and it is later discovered that such equipment, materials or services are not suitable for their intended purpose. A solution analogous to that indicated in the preceding paragraph may be adopted. If the contractor has assumed responsibility for the entire design and construction of the works or a portion of the works, the contractor should be obliged to evaluate the specified equipment, materials or services prior to using them. If he discovers their unsuitable character, he should be entitled to the costs entailed in changing the specifications and drawings. If he does not discover the unsuitable character, he should be liable if the works are as a result defective. If, however, the contractor has assumed responsibility only for constructing the works in accordance with specifications and drawings to be supplied by the purchaser, he should not be liable if he uses the specified equipment, materials or services and the works are as a result defective.

D. *Hierarchy of documents*

27. The parties should consider the possibility that the documents defining the scope and quality of the works contain some inconsistent provisions. It may be advisable to provide a method of determining which document is to prevail in such cases. Parties may wish to provide that, where the principal contract document is inconsistent with other documents, it should always prevail. In particular, the contract should clarify that the obligations of the contractor with regard to the required type and operational capability of the works should, in the event of a conflict, prevail over the scope of the construction as indicated in the specifications and drawings. Where specifications and drawings are inconsistent, which document is to prevail may depend on the aspect of the construction involved. For example, it is often provided that in respect of civil engineering, drawings are to prevail over specifications. A possible approach may be to provide that, unless the contract

provides otherwise in respect of any special aspect of the construction, specifications should prevail over drawings. This approach may be justified on the basis that written terms may be considered a more reliable reflection of the agreement between the parties than formulations contained in drawings. As regards other documents, parties may wish, to the extent possible, to determine and indicate in the contract the order of priority among them. Where it is not possible to indicate an order of priority, the contract should provide that any dispute between the parties as to priority should be settled in dispute settlement proceedings (see the chapter "Settlement of disputes").

E. Extent of confidentiality of specifications, drawings and other technical documents

28. The extent of the confidentiality of the information contained in the specifications, drawings and other technical documents is an important question which should be settled in the contract. The parties may wish to provide that the party who prepares the specifications and drawings should also retain the ownership in them. In works contracts it is usual for the contract to provide that the contractor retains ownership in the technical documents relating to the construction delivered to the purchaser. The purchaser has the right to use such documents for the purposes for which they are intended (e.g. the performance of construction obligations of the purchaser), but he may not disclose the information contained therein to a third person without the contractor's prior consent. The same principle should be applicable to technical documents which the purchaser delivers to the contractor.

29. In some cases, however, the parties may wish to provide that the technical documents supplied by one party will become the property of the other party. For example, if the purchaser intends to construct a second identical or similar works himself, he may wish to obtain ownership not subject to restriction on their use of the technical documents prepared by the contractor. It is usual for the contract to provide that technical documents which the purchaser receives for the purposes of maintenance are to be subject to the ownership of the purchaser. The contract may, however, provide that all such technical documents, even when they are owned by the purchaser, remain confidential and may not be disclosed to third persons.

[A/CN.9/WG.V/WP.13/Add.2]

Completion, acceptance and take-over

Summary

The contract should contain provisions dealing with completion of construction, acceptance of the works and take-over of the works and other property. Such provisions should establish when these events occur and their legal consequences (paragraphs 1-2).

In general, completion of construction should occur when equipment, materials and services required under the contract have been supplied by the contractor. The contract should specify a date by which, or a period of time within which, construction should be completed (paragraphs 3-7). The contract may contain a time schedule establishing the sequential order in which construction activities are to take place. Where several contractors are to participate in the construction, a time schedule should, whenever possible, be included in each contract, and the contractor should be obligated to perform in accordance with the time schedule (paragraphs 8-11).

A time for completion, or an obligatory time for construction of a portion of the works under a time schedule, should be extended in certain situations (paragraphs 12-16). The contractor should be obligated to deliver to the purchaser notice of an event which would entitle the contractor to an extension of time and of which the purchaser may not be aware. He should also be obligated to deliver to the purchaser notice of the length of the extension which he considers to be reasonable, when the facts needed to ascertain the length of the extension become known to him (paragraph 15).

Completion of construction should be proved through mechanical completion tests. If the results of the mechanical completion tests are successful, construction might be considered to have been completed as of the date proposed by the contractor for the commencement of the tests, or, alternatively, on the date of successful completion of the tests (paragraphs 17-19).

After completion, acceptance of the works by the purchaser should occur if the works is free of serious defects. In general, this should be proved through performance tests. However, the purchaser should be entitled to accept if he so desires even if performance tests are not successful (paragraphs 20-21).

Acceptance should be considered to occur at the time of successful completion of performance tests. If the performance tests are not conducted at the time required under the contract, the contract should contain appropriate provisions to determine when acceptance occurs. If performance tests are not needed, acceptance should be considered to occur when completion of construction is proved (paragraphs 24-25). It may be advisable for the contract to require the execution of an acceptance protocol (paragraphs 26-27).

The contract should set forth the legal effects of acceptance. At the time of acceptance, the contractor's obligations to hand over the works to be taken over by the purchaser should arise, the risk of loss of or damage to the works not already borne by the purchaser should pass from the contractor to the purchaser, and the period for the quality guarantee should commence to run. Acceptance may also have other legal effects (paragraphs 28-31).

The contract should provide that take-over occurs when a party takes possession of equipment, materials,

the plant during construction or the completed works, as the case may be. In cases of take-over other than take-over of the works by the purchaser after acceptance, the main consequence of take-over should be that the risk of loss of or damage to the property passes to the party taking it over, unless he already bears the risk (paragraph 32).

The contract may provide for the purchaser to take over property prior to acceptance, for example, where a portion of the works is completed by a separate contractor, where the works is to be operated during a trial operation period, where the contract is terminated, or where construction is to be completed by a new contractor at the expense and risk of the contractor (paragraphs 33-38). The contract may provide for the execution of a take-over protocol (paragraph 39). The contract may also provide for the take-over of certain property by the contractor (paragraphs 40-41).

* * *

A. General remarks

1. The main obligation of the contractor should be to complete construction of the works in accordance with the contract. Thereafter, acceptance of the works by the purchaser should occur and the works should be handed over to the purchaser. In some situations the purchaser may take over the works without accepting it. The contract provisions on completion, acceptance and take-over should be harmonized with other contractual provisions, in particular with the provisions on failure to perform and the passing of risks. The way in which the time and consequences of completion, acceptance and take-over are to be settled may depend upon the type of works contract and the nature of the works to be constructed.

2. The contract should clearly establish when completion, acceptance and take-over occur and their legal consequences. In general, the contract should provide that the completion of construction occurs when equipment, materials and services required under the contract have been supplied by the contractor. The contract should require completion to be proved through successful mechanical completion tests. Generally, acceptance should occur when the contractor proves through successful performance tests that the completed works functions substantially as required by the contract and is therefore without serious defects, although acceptance might also occur in some cases in which the performance tests are not held or when the results of such tests are not successful. However, the contract should ensure that even after acceptance of the works the purchaser will have remedies in respect of defects discovered before acceptance or notified during the guarantee period, provided the contractor is liable for them (see the chapter "Failure to perform"). Take-over by a purchaser should occur when he takes possession of equipment, materials, the plant during construction or the completed works, as the case may be, and by a contractor when he takes possession of equipment or materials.

B. Completion of construction

1. Time for completion of construction

3. The contract should clearly set forth the time when the construction must be completed by the contractor. The time for completion may be determined either by a fixed date or by reference to a period of time. If a fixed date is used, the contract should specify the situations in which this date may be postponed and the length of postponement. If the contract requires construction to be completed within a specified period of time, the contract should specify when the period is to commence, under what circumstances it will cease to run or will be prolonged and the permissible extent of the prolongation.

4. In determining when a period of time for completion of construction commences, the following dates may be considered:

(a) The date on which the contract enters into force;

(b) The date on which the contractor receives notice from the purchaser that all licences for import of equipment and materials and official approvals for construction of the works required in the purchaser's country have been granted to the purchaser, or that construction should begin;

(c) The date of receipt by the contractor of an advance payment of a portion of the price to be made under the contract;

(d) The date on which the purchaser delivers to the contractor a design, drawings or descriptive documents needed for the commencement of construction.

5. The contract might include more than one of the dates mentioned in the preceding paragraph, in which case the time period should commence from the latest of those dates.

6. If only one contractor participates in the construction of the works, it would generally be in the interest of the purchaser for the construction to be completed as early as possible and for the fixed date or the end of the period of time to be considered as a final date for completion, with earlier completion being permissible or even encouraged. In some cases, however, the purchaser may not wish construction to be completed earlier for various practical reasons, including his financial arrangements.

7. Exceptionally, in some cases which involve complex and long-term construction, it may not be possible at the time of entering into the contract to specify a fixed date or a period of time for completion of construction. In such cases the contract may set forth an estimated date or period of time and provide that the definite time for completion must be agreed later, within a period of time to be specified in the contract. If the parties fail to agree, the time for completion should be determined in dispute settlement proceedings (see the chapter "Settlement of disputes"). The pendency of such proceedings should not interrupt the performance of the contract.

2. *Time schedule for construction and completion*

8. The contract may contain a time schedule to establish the sequential order in which construction activities are to take place. A time schedule is desirable in order to facilitate an evaluation of the progress of the construction. It may also facilitate the fixing of an extension of time for completion in the case of a variation or an obstacle to construction. The time schedule may refer to the sequencing and scheduling of individual tasks which are required for the completion of construction, without imposing any legal obligations. Alternatively, it may establish obligatory interim completion dates or periods of times for phases of the construction or portions of the works. A contractor who fails to meet such obligatory dates or periods of time should be liable for delay (see the chapter "Failure to perform", paragraphs 36-38). In addition to the contractor's obligations with respect to construction of the works, the time schedule should reflect any obligations of the purchaser relating to construction (e.g. handing over of the site or supply of equipment or materials). When a time schedule is contained in the contract, the contractor should be obliged to deliver to the purchaser periodically during construction (e.g. on the first day of each month) a report on the progress of construction.

9. The time schedule should be prepared in such a form (e.g. graphically) as would permit the actual progress of the construction to be recorded and compared with the time schedule. One method for designing the time schedule which the parties may wish to consider is the so-called "critical path method". In this method the entire construction is divided into individual tasks and each task is assigned a period of time within which it is to be performed. These periods are incorporated in a schematic diagram depicting the sequence and interrelationship of construction activities. Critical activities, i.e. activities on which other activities depend, form a continuous chain, known as the critical path, through the schematic diagram. This method may facilitate the evaluation of the consequences of delay in certain construction activities upon other such activities.

10. Where several contractors are to participate in the construction (the separate contracts approach; see the chapter "Choice of contract type"), a time schedule of the sequence of construction should be included in each contract to enable the purchaser to co-ordinate the construction of the entire works. The contractor should be obligated to construct in accordance with the time schedule. The sequence of the construction under each contract should be harmonized with an overall time schedule for the construction of the entire works. However, where it is not possible to agree on a time schedule at the time of entering into a contract, the contract might only stipulate the period of time within which the construction required by the contract must be completed. A precise time for the commencement of construction may be determined later by the purchaser, taking into consideration the time schedule for construction agreed with other contractors participating

in the construction. However, the contract may provide that if the purchaser requires the construction to commence before or after specified dates, the contractor would be entitled to a certain adjustment in the price. The contract may also provide that if the purchaser does not require the commencement of construction within a period specified in the contract, the contractor may be entitled to terminate the contract.

11. Should the contract provide that the time schedule is to be agreed upon by the parties at a later date, the contract should also provide a procedure to be followed for reaching such agreement. If the time for completion is extended, the time schedule for construction should be adapted to the new time for completion. Failure to agree on the time schedule or its adaptation should entitle either party to resolve the disagreement in appropriate dispute settlement proceedings.

3. *Extension of time for completion*

12. The time for completion of the construction specified in the contract, or an obligatory time for construction of a portion of the works under a time schedule, should be extended if certain events occur. The parties may wish to provide for such an extension in the following situations:

(a) The construction has been suspended by the purchaser for his convenience or by the contractor because of the purchaser's failure to perform an obligation (see the chapter "Suspension of construction", paragraphs 6 and 17, and the chapter "Failure to perform", paragraph 16);

(b) Further work must be performed by the contractor due to a variation of the construction ordered by the purchaser (see the chapter "Variation clauses") or due to safety, environmental or other administrative regulations binding on the contractor which are issued after the conclusion of the contract;

(c) Further work must be performed by the contractor to make good loss or damage the risk of which is borne by the purchaser, or to make good loss or damage caused by the purchaser, or a person employed by the purchaser for construction;

(d) The purchaser, or a person employed by him for construction, prevents the contractor from constructing the works in accordance with the contract;

(e) The construction is prevented as a result of an exempting impediment (see the chapter "Exemptions").

13. If, in exceptional cases, the contract provides that liquidated damages are to be payable even if failure to complete on time is due to an exempting impediment, the time for completion should not be extended as a result of the occurrence of such an impediment. If the time required for completion were extended, an inconsistency would result because the event giving rise to the obligation to pay liquidated damages (i.e. failure to complete by the date required in the contract) would not occur.

14. The contract should provide that if grounds arise for an extension of time for completion, the time for completion of the construction is to be automatically extended by a period of time reasonably needed for completion, taking into account any further construction which must be effected, the period of time during which the contractor was prevented from continuing with the construction, or the period of time during which the construction was suspended. While the period of extension should be reasonably commensurate with the duration of a suspension or of an obstacle, it need not in all cases be of the same length as the duration of the suspension or the obstacle. In some cases it may be reasonable not to extend the time for completion at all, in particular if critical construction activities are not affected. For example, additional time might not be necessary in the case of a short interruption due to adverse weather conditions at the beginning of long-term construction.

15. In respect of certain events which would entitle the contractor to an extension of time for completion, but of which the purchaser may not be aware (e.g. those mentioned in (c) and (e) of para. 12, above), the contractor should be obliged to deliver promptly to the purchaser notice of the occurrence of such events. In all cases, when the extent of additional construction to be effected by the contractor or the duration of a suspension or an obstacle becomes known to the contractor, he should be obliged to deliver to the purchaser notice of the length of the extension which he considers to be reasonable. Where, within a specified period of time to commence from the time when the contractor delivers the latter notice to the purchaser, the parties fail to agree on the extension of time which is to be given, either party should be entitled to ask for a settlement of the issue in dispute settlement proceedings. The contractor should be obliged to continue with any construction which is not affected by the event entitling him to an extension of time.

16. The issue of extension of time for completion in the case of variation of the construction by the purchaser and the procedure to be followed in this connection are discussed in the chapter "Variation clauses".

4. *Proof of completion: mechanical completion tests*

17. When the contractor considers the construction to have been completed, he should deliver notice thereof to the purchaser, and the contractor should be obliged to prove the completion through mechanical completion tests having successful results. The purpose of such tests is to demonstrate through visual inspection of the works and mechanical operation of equipment that the entire construction undertaken by the contractor has been completed in accordance with the contract (see the chapter "Inspection and tests"). If during these tests it is discovered that certain items are missing, but their absence does not prevent or delay the operation of the works, the results of the tests should be considered successful.

18. If the results of the mechanical completion tests are successful, the construction might be considered to have been completed as of the date proposed by the contractor for the commencement of the tests or, alternatively, on the date of successful completion of the tests. However, if the latter date is chosen for the date of completion, the contract should provide that if, due to obstacles for which the contractor is not responsible, the tests cannot be completed by the time set forth in the contract for the completion of construction, the contractor is not to be regarded as being in delay.

19. If the mechanical completion tests are not conducted on the scheduled date, or if the results of the tests are not successful, completion will not be proved. The contract should contain appropriate requirements for the tests to be conducted at some later date or to be repeated. If certain formalities (e.g. the participation of an inspecting organization) are required for the conducting of mechanical completion tests, and if the tests cannot be conducted due to an inability to comply with these formalities which persists beyond the period of time specified in the contract for the conducting of the tests, the contract should permit the contractor to prove in any other manner the completion of the construction (see the chapter "Inspection and tests").

C. *Acceptance*

20. The contract should provide that after completion, acceptance of the works by the purchaser is to occur if the works are free of serious defects (see the chapter "Failure to perform"). In general, this should be proved through performance tests (see the chapter "Inspection and tests"). The performance tests should not be conducted until the mechanical completion tests have proved to be successful, unless the purchaser consents to the conduct of performance tests without the conduct of mechanical completion tests. In some cases, however, the contract may permit the mechanical completion tests and the performance tests to be conjoined in the same test procedures. In other cases, due to the nature of construction, performance tests may not be needed.

21. Even when the performance tests are not successful, however, the purchaser should be entitled, if he so desires, to accept the works. Such acceptance may be effected by the execution by the parties of an acceptance protocol (see paras. 26 and 27, below).

22. If certain formalities (e.g. the participation of an inspecting organization) are required for the conducting of performance tests, and if the tests cannot be conducted due to an inability to comply with these formalities which persists beyond the period of time specified in the contract for the conducting of the tests, the works should be put into operation. The operation of the works for a period of time equal to the period of time specified in the contract for the duration of performance tests should be deemed to constitute performance tests.

23. If the construction of different portions of the works is completed at different times and these portions can be tested and used independently, each portion may be accepted separately, if the contract provides for such separate acceptance. In such cases, the rules in respect of the completion and acceptance of the entire construction should apply to the completion and acceptance of such portions of the construction. However, in some cases where several contractors participate in the construction of the works, it may not be possible to test or put into operation the equipment supplied and erected by one of these contractors before the entire works is completed. In such cases, the conduct of performance tests and acceptance cannot occur until the completion of construction by other contractors, and the contract may provide that the portion of the works completed by the contractor should be taken over by the purchaser.

1. *Time of acceptance*

24. As acceptance of the works has significant legal effects, the contract should clearly stipulate when acceptance occurs. If performance tests are conducted with successful results, acceptance should be considered to occur at the time of the completion of the tests, whether or not the purchaser signs a performance test protocol (see the chapter "Inspection and tests") or performs an act of acceptance, such as the signing of an acceptance protocol. If there is a dispute between the parties as to whether the performance tests were successful, and it is later found that the tests were successful, acceptance would have occurred at the time of completion of the tests.

25. If the performance tests are not conducted on the scheduled date, or if the results of the tests are not successful, acceptance will normally not occur, and the contract should contain appropriate requirements for the tests to be postponed to some later date or to be repeated, as the case may be (see the chapter "Inspection and tests"). If the postponed tests are not conducted due to reasons for which neither party is responsible, acceptance should not occur until the tests can be conducted and their results are successful, unless the purchaser decides to accept even though the tests were not conducted. However, for the case where the postponed tests are not conducted due to reasons for which the purchaser is responsible, the contract should provide for acceptance to occur when the contractor despatches to the purchaser a written notice that acceptance is considered to have occurred. If the postponed tests are not conducted due to reasons for which the contractor is responsible, no acceptance should occur unless the purchaser decides to accept even though the tests were not conducted. In cases where performance tests are not needed, acceptance should be considered to occur at the time when completion of construction is proved. Disputes as to whether the works has been accepted and, if so, on what date, should be settled in dispute settlement proceedings.

2. *Acceptance protocol*

26. It may be advisable for the contract to require the execution of an acceptance protocol, signed by both parties, in which the acceptance of the works by the purchaser would be confirmed. A protocol which is binding on both parties is preferable to a unilateral act evidencing acceptance. Such a protocol would minimize disputes as to whether and on what date the works has been accepted. In addition, by means of an acceptance protocol the purchaser could indicate his acceptance of the works in cases where acceptance would not otherwise occur (para. 21, above).

27. The acceptance protocol should evaluate the results of the performance tests, if it was not possible to present such an evaluation in the performance tests protocol (see the chapter "Inspection and tests"), and should indicate the date of acceptance. Normally, this should be the date when the performance tests have been completed with successful results. In addition, it may be advisable for the protocol to include a time schedule for the supply of items which were discovered during the mechanical completion tests to be missing (if such a time schedule is not already included in the mechanical completion tests protocol, see the chapter "Inspection and tests"), and for the cure of the defects discovered during the performance tests. If the parties differ as to certain issues, such as the time-limit for the cure of discovered defects, the protocol should reflect the views of both parties. Such differences should be settled in dispute settlement proceedings.

3. *Legal effects of acceptance*

28. The contract should clearly set forth the legal effects of acceptance. The parties may agree that at the time of the acceptance, the contractor's obligation to hand over the works and the purchaser's obligation to take it over arise, that the risk of loss of or damage to the works passes from the contractor to the purchaser, and that the period for the quality guarantee commences to run. In addition, acceptance may affect the remedies available to the purchaser in respect of defects discovered in the works. Some remedies for defects in the works (e.g. price reduction) may be available only if the works is accepted. The conditions under which other remedies (e.g. termination of the contract) are available may differ depending on whether or not the works is accepted (see the chapter "Failure to perform", paragraphs 55 and 69). The time of acceptance may also be relevant for certain other issues, for example, the payment of a portion of the price (see the chapter "Price").

29. After acceptance by the purchaser, the contractor should be obliged promptly to hand over the works to be taken over by the purchaser and to leave the site.

30. The contract should provide that the risk of loss of or damage to the works not already borne by the purchaser should pass from the contractor to the purchaser at the time of acceptance of the works. In

certain situations, the risk of loss of or damage to the plant during construction may already be borne by the purchaser prior to acceptance, such as in situations where several contractors are employed for the construction of the works (see the chapter "Allocation of risk of loss or damage"), or where the completed works is taken over by the purchaser for the purpose of a trial operation prior to the performance tests and acceptance (see paras. 35 and 36, below).

31. The period for the quality guarantee in respect of the works should, generally, commence to run at the time of acceptance. In some cases, however, a portion of the works which has been completed by the contractor and accepted by the purchaser is not to be operated before completion of construction and the conduct of performance tests in respect of the other portions of the works. In these cases, the guarantee period may commence to run at a time other than the acceptance of that portion of the works (see the chapter "Failure to perform", paragraphs 30 and 31).

D. Take-over

32. The contract should provide that take-over occurs when a party takes possession of equipment, materials, the plant during construction or the completed works, as the case may be. In cases of take-over other than take-over of the works by the purchaser after acceptance (see para. 29, above), the main consequence of take-over should be that the risk of loss of or damage to the property taken over passes from the party handing it over to the party taking it over, unless the latter party already bears the risk (e.g. where the risk passed at the time when equipment was handed over to the first carrier for transmission to the purchaser). In addition, an obligation of the purchaser to pay a portion of the price may arise upon his taking over certain property (see the chapter "Price").

1. Take-over by purchaser

33. In addition to providing for the purchaser to take over the works at the time of his acceptance of the works, the contract may provide for the purchaser to take over property prior to acceptance of the works.

(a) Take-over after completion of construction by one of several contractors

34. This is discussed in para. 23, above.

(b) Take-over for trial operation

35. In some works contracts it may be agreed that the performance tests are to be conducted after the works has been run in, the purchaser's personnel have become fully acquainted with the operation of the works and the works is running under normal operating conditions. This approach may give greater assurance to the

purchaser that the works, as operated by his own personnel, do in fact meet the performance standards specified in the contract. This is normal practice under a product-in-hand contract (see the chapter "Choice of contract type") and may be advisable in any other contract in which the contractor undertakes to train the purchaser's personnel to operate and maintain the works. If the parties choose this approach, the contract should provide for the works to be taken over after the completion of construction is proved, and should specify the duration of the trial operation period. This period should commence at the time the works is taken over. The contract should provide for the trial operation period to cease to run during any interruption in the operation of the works for which the contractor is responsible. Normally, performance tests should be conducted at the end of the trial operation period.

36. During the trial operation period, the works should be operated by the purchaser's personnel under the direction and supervision of the contractor's personnel. The costs of the contractor's personnel should be borne by the contractor and other costs connected with the operation of the works should be borne by the purchaser. However, the contractor should be liable to cure at his own expense all defects discovered during the trial operation, unless they are caused by events covered by the risk borne by the purchaser, or by a failure of the purchaser's personnel to observe instructions given by the contractor. The output of the works during the trial operation should be owned by the purchaser.

(c) Take-over in case of termination of contract

37. Where the contractor fails to perform his obligations in accordance with the contract, the right of the purchaser to terminate the contract is, generally, limited to uncompleted or defective portions of the works (see the chapter "Termination", paragraphs 6-10). In such cases the purchaser should be entitled to require the portions of the works already constructed to be handed over to him in order that the construction might be completed, or that discovered defects be cured, by himself or by another contractor. The take-over of the uncompleted or defective works should be effected within a short period of time, to be specified in the contract, after the termination. The guarantee period in respect of the portion of the works taken over by the purchaser should commence to run from the time when the entire works is completed and put into operation.

(d) Take-over in case of completion of construction at contractor's expense and risk by another contractor

38. If the purchaser chooses the remedy of completing the construction by a new contractor at the expense and risk of the contractor (see the chapter "Failure to perform", paragraph 38), the contractor should be obliged to hand over the uncompleted works to be taken over by the purchaser. The time of the take-over should be the time when the contractor is obliged to

stop the construction and leave the site (see the chapter "Failure to perform", paragraph 65).

2. *Take-over protocol*

39. In all cases of take-over noted in paras. 34-38, above, it may be advisable for the contract to require the execution of a take-over protocol, signed by both parties, which would indicate the take-over of the works by the purchaser. The protocol should also indicate the date of take-over and the condition of the works at the time of take-over.

3. *Take-over by contractor*

40. In cases where defects are to be cured by the replacement of defective equipment or materials, or where the contract is terminated because of defects in the work, the contractor may be obliged to take over defective equipment or materials, if they are in the possession of the purchaser, and to remove them from the site. In some cases, however, the contractor may be permitted under the contract to take them from the site only after having replaced them with new equipment or materials.

41. If the contract is terminated by the contractor due to failure to perform by the purchaser, the contractor may be entitled to take over equipment or materials supplied by him and in the possession of the purchaser if they have not been paid for by the purchaser. Costs connected with taking over the equipment or materials should be borne by the purchaser.

[A/CN.9/WG.V/WP.13/Add.3]

Allocation of risk of loss or damage*

Summary

The contract should clearly provide who bears the risk of loss of or damage to equipment and materials, the plant during construction and the completed works and what are to be the consequences of such risk (paragraphs 1-4).

The parties may sometimes exclude from the risk to be borne by the contractor certain kinds of accidental events or certain acts of third persons (the so-called "excepted risks"). This exclusion will in practical effect allocate those "excepted risks" to the purchaser (paragraph 8).

The determination of the time when the risk of loss of or damage to equipment and materials supplied by the contractor for incorporation in the works should pass from the contractor to the purchaser may depend

on who is to be in possession and take care of such equipment and materials. Furthermore, the possibility of insuring the equipment and materials, and the time when the condition of the equipment and materials can be checked, would be relevant (paragraphs 11-16). If only one contractor is employed to construct the entire works, the risk of loss of or damage to the plant during construction and the completed works should be borne by him until the acceptance or the take-over by the purchaser (paragraphs 20 and 21). If several contractors participate in the construction, the risk in respect of the plant during construction and the completed works should generally be borne by the purchaser (paragraph 22).

When the contractor bears the risk, he should be obliged to make good the loss or damage at his expense with all possible speed. If the risk is borne by the purchaser, the contractor should be obliged, if so required by the purchaser, to make good the loss or damage at the purchaser's expense as soon as he can conveniently do so (paragraphs 23-24).

The contract should also provide for the passing of the risk of loss of or damage to equipment and materials supplied by the purchaser for incorporation in the works (paragraphs 17-19), and for the allocation of the risk of loss of or damage to the contractor's tools and construction machinery to be used for effecting the construction (paragraph 25).

* * *

A. *General remarks*

1. During the construction of the works, physical loss or damage for which neither party is responsible may be caused to equipment or materials to be incorporated in the works, to the plant during construction, or to the completed works, as well as to tools and construction machinery to be used by the contractor for effecting the construction. Such loss or damage may be caused by accidental events, or by the acts of third persons for whom neither party is responsible. The likelihood of such loss or damage is usually higher in connection with a works contract than with certain other types of contracts because the construction involved is frequently a long-term and complex process. It is therefore advisable for the contract clearly to allocate the risk of such loss or damage during the construction, i.e. to determine the scope of the risk of such loss or damage to be borne by each party. When the risk is borne by one of the two parties, he will have to bear the financial consequences of the loss or damage resulting from such a risk without being able to obtain compensation for those financial consequences from the other party.

2. The accidental event or act of a third person causing the loss or damage may also cause a failure of performance by the party bearing the risk. For example, as a result of having to repair the plant damaged by a storm, the contractor may be unable to meet his completion date, and this may result in loss to the

*This chapter has previously been referred to under the title "Passing of risks".

purchaser. Whether the party failing to perform is liable in damages for this loss will depend on whether the accidental event or act of the third person constituted an exempting impediment (see the chapter "Exemptions").

3. The question of who bears the risk of loss or damage is settled in different ways under different legal systems, and some legal rules may be inappropriate to a works contract, such as a rule that risk is to be borne by the owner of property. Under some legal systems, the risk of loss of or damage to property may pass to a purchaser prior to its handing over when the property is clearly identified to the contract by marking, shipment, notice given to the purchaser, or other means. In addition, legal rules may provide that equipment and materials, once incorporated in a plant, form part of the plant, and that the rules governing the bearing of risk in relation to the plant also apply to the equipment and materials so incorporated. In principle, however, many legal systems permit the parties to agree on who bears the risk, subject to certain limitations.

4. In determining how to allocate the risk of loss or damage between the parties, they may wish to consider the interplay of various factors. Thus, it may be advantageous to allocate the risk to the party who has the duty to care for the property, as this may lessen litigation over whether the loss or damage was caused by a failure to take due care of the property, or by an accidental event or act of a third person which could not have been prevented. It may also be advisable to allocate the risk to the party who is able to insure the goods at the least cost, or who under the normal practice relating to a works contract will provide the insurance cover for the loss or damage in question, or who is in a better position to pursue a claim against an insurer (see the chapter "Insurance"). It may also be advantageous to allocate the risk to the party who can best salvage and dispose of the damaged property.

5. In addition, it should be noted that it is generally not advisable to provide in the contract for more than one passing of risk between the parties in relation to the same risk (e.g. from purchaser to contractor, and then from contractor to purchaser). A multiple passing of risk is likely to create complexity and uncertainty as to who bears the risk.

6. The financial consequences of bearing a risk may be considerably mitigated if the risk is insured against. However, since certain risks connected with the execution of a works contract may not be insurable on reasonable terms, it should be noted that a party may be compelled to bear certain risks against which he has not insured (see the chapter "Insurance").

7. The risk borne by a contractor may cover loss of or damage to equipment and materials to be incorporated in the works, the plant during construction, and the completed work until acceptance. Whether the risk in respect of all, or only some, of these items should be borne by the contractor may depend on the type of works contract in question.

8. The parties may sometimes exclude from the risk to be borne by the contractor loss or damage caused by certain events. In practice, loss or damage caused by war, rebellion, other military action, riots (unless solely caused by employees of the contractor or his sub-contractors), nuclear fuel or waste, pressure waves of aircraft, earthquake, or floods is often excluded. This exclusion usually applies only to cases where the loss or damage is caused by the events in the country where the works is to be constructed. If, however, the purchaser is to bear such risks in respect of loss of or damage to equipment or materials supplied by the contractor caused by such events even outside the country where the works is being constructed, the contract should clearly provide when the purchaser should commence to bear such risks (e.g. at the time when the equipment or materials are handed over to the first carrier for transportation to the site).

9. In some works contracts, the scope of the risk borne by a party is limited only to loss or damage caused by natural accidental events (e.g. floods, storms) and the allocation of the risk of loss or damage caused by a third person for whom neither party is responsible is left to the applicable law. This approach may, however, be inadvisable because situations may often arise in practice where it is not clear whether the loss or damage was caused by an accidental event or by such a third person.

10. In situations where equipment, materials, the plant during construction or the completed works are in the possession of the contractor, but the risk of loss of or damage to such property is borne by the purchaser, it is advisable to provide that the contractor should take all reasonable precautions to prevent or minimize such loss or damage. The contractor should also be obligated to notify the purchaser promptly of loss or damage which occurs.¹

B. Equipment and materials supplied by contractor for incorporation in works

11. The time when the risk should pass from the contractor to the purchaser may depend on who is to be in possession of the equipment and materials and who is to take care of them. Furthermore, the risk should not pass at a time when there is only a limited possibility of checking the condition of the equipment and materials. If the equipment and materials are not properly checked at the time the risk passes and they are later found to be lost or damaged, it may be difficult to determine when the loss or damage occurred and who is to bear the risk thereof.

Illustrative provision

"In constructing the works and performing any other obligation under the contract concerning any equipment and materials, the plant during construction or the completed works, the contractor shall take all reasonable precautions to prevent any loss thereof or damage thereto, the risk of which is borne by the purchaser, and to minimize the amount of such loss or damage. The contractor shall promptly notify the purchaser of any such loss or damage after he has discovered it or ought to have discovered it."

12. The type of works contract may also be relevant to determine the time the risk should pass. If only one contractor assumes responsibility for the entire construction of the works (in particular, in the case of a turnkey contract), the risk of loss of or damage to equipment and materials to be incorporated in the works should be borne during the construction by the contractor. If, in such cases, the purchaser were to bear the risk at any time during the construction, and the works fails to operate in accordance with the contract, disputes may arise as to whether such failure to operate is due to loss of or damage to equipment or materials in respect of which the risk was borne by the purchaser, or to defective performance by the contractor.

13. If, however, the parties to a turnkey contract do agree that the risk during the construction should be borne by the purchaser, they may reduce the difficulty mentioned in the previous paragraph by stipulating that the contractor is responsible for the failure of the works to operate unless he proves that the failure was caused by loss or damage the risk of which was borne by the purchaser, and unless he has notified the purchaser of such loss or damage promptly after he has discovered it or ought to have discovered it.

14. If several contractors participate in the construction of the works, the time when the risk of loss of or damage to the equipment and materials is to pass from a contractor to the purchaser may depend on whether or not the contractor's personnel are to be present at the site at the time of delivery. If the contractor's personnel are to be present and to take over the equipment and materials, which are to remain in the contractor's possession until they are incorporated in the works, the parties may wish to agree that the contractor is to bear the risk until such incorporation.²

15. If, however, the contractor's personnel are not to be present at the site at the time of delivery, and the equipment and materials are to be taken over and stored by the purchaser until their use for the construction by the contractor, the risk should pass to the purchaser at an appropriate time and remain with the purchaser. The parties may wish to consider which of the times set forth below may be an appropriate time for the passing of the risk to the purchaser:

(a) The time when the equipment and materials are handed over to the first carrier for transmission to the purchaser under the contract, or effectively pass the ship's rail at the agreed port of shipment;

(b) The time when the customs formalities are concluded at the frontier of the country from which the equipment and materials are exported; or

²*Illustrative provisions*

"(1) The contractor shall bear the risk of any loss or damage from any cause whatsoever to any equipment and materials supplied by him until their incorporation in the works.

"(2) However, the risk borne by the contractor shall not cover any loss or damage caused by the purchaser or any person employed by him (or caused by . . . (here indicate "excepted risks"; see para. 8, above) in the country where the works is to be constructed)."

(c) The time when the equipment and materials are taken over by the purchaser or put at the disposal of the purchaser at the site.³

16. An alternative approach is to provide that the risk is to pass in accordance with the relevant rule under the International Rules for the Interpretation of Trade Terms (INCOTERMS) of the International Chamber of Commerce applicable to a trade term (e.g. CIF or FOB) chosen in the contract by the parties.⁴

C. Equipment and materials supplied by purchaser for incorporation in works

17. Under some works contracts, the purchaser is obligated to supply equipment or materials to be used by the contractor for the construction of the works. In these cases the contract should clarify which party bears the risk of loss of or damage to such equipment or materials.

18. The parties may wish to provide that, if the contractor's personnel are to be present at the site at the time of the supply by the purchaser and the contractor bears the risk in respect of the plant during construction and the completed works until acceptance, the risk in respect of the equipment or materials supplied should pass from the purchaser to the contractor at the time when they are taken over by the contractor. If the contractor fails to take them over, the risk may pass from the time when the contractor is in delay in taking them over. This approach has the advantage that, if after completion of the construction a failure of the works to operate in accordance with the contract were to occur involving such equipment or

³*Illustrative provisions*

"(1) The risk of any loss or damage from any cause whatsoever to equipment and materials to be supplied by the contractor for incorporation in the works shall pass from the contractor to the purchaser at the time when [the equipment and materials are handed over to the first carrier for transmission to the purchaser under the contract] [the equipment and materials effectively pass the ship's rail at the agreed port of shipment] [the customs formalities are concluded at the frontier of the country from which the equipment and materials are to be exported under the contract] [the equipment and materials are taken over by the purchaser or put at the disposal of the purchaser at the site].

"(2) [Identical to footnote 2, para. (2), above.]"

⁴*Illustrative provision*

"The equipment and materials to be supplied by the contractor for incorporation in the works shall be delivered on the basis of [FOR . . . (named departure point)] [FOT . . . (named departure point)] [FAS . . . (named port of shipment)] [FOB . . . (named port of shipment)] [C & F . . . (named port of destination)] [CIF . . . (named port of destination)] [Freight/Carriage Paid to . . . (named point of destination)] [Freight/Carriage and Insurance paid to . . . (named point of destination)] [Ex Ship . . . (named port of destination)] [Ex Quay (duty paid . . . named port)] [Delivered at Frontier . . . (named place of delivery at frontier)] [Delivered Duty Paid at . . . (named place of destination in the country of importation)] and the time when the risk shall pass from the contractor to the purchaser shall be determined in accordance with the International Rules for the Interpretation of Trade Terms (INCOTERMS) of the International Chamber of Commerce in force on the date of the conclusion of this contract." (INCOTERMS as revised in 1980 are contained in ICC document No. 350.)

materials, disputes between the parties as to the cause of such failure might be reduced. The advantage of this approach is less when the purchaser bears the risk in respect of the plant during construction and the completed works. In such a case, this approach results in a double passing of risk (from the purchaser to the contractor and from the contractor to the purchaser when the equipment and materials are incorporated in the plant). Furthermore, disputes as to the cause of a failure of the works to operate may not be substantially reduced, as the purchaser bears the risk in respect of such equipment and materials after their incorporation in the plant. Accordingly, the parties should consider whether the risk is to remain with the purchaser or whether the risk should pass to the contractor.

19. Where, because the contractor's personnel will not be at the site at the time of supply, the parties have determined that the risk in respect of equipment and materials to be supplied by the contractor should pass to the purchaser at the time of such a supply or before they are supplied at the site (see para. 15, above), it would be advisable to provide that the risk in respect of equipment and materials to be supplied by the purchaser should also remain with the purchaser.

D. Plant during construction and completed works

20. If only one contractor is employed to construct the entire works (in particular, in the case of a turnkey contract), it is advisable for the contract to provide that the contractor bears the risk of loss of or damage to the plant during construction and the completed works until acceptance (see the chapter "Completion, acceptance and take-over"). As already indicated in para. 12, above, this approach may prevent disputes as to whether the failure of the works to operate in accordance with the contract is due to a defect for which the contractor is responsible, or to loss or damage the risk of which was borne by the purchaser.

21. The time when acceptance occurs will depend on the provisions in the contract regulating this issue. If the contract does not provide for acceptance to occur automatically in certain situations but requires an act of acceptance by the purchaser, and if the purchaser fails to accept, the risk may pass at the time when the purchaser is in delay in acceptance. If a trial operation is to take place before acceptance of the works, the contract may provide that the risk is to pass at the time of take-over of the works by the purchaser (see the chapter "Completion, acceptance and take-over").

22. If two or more contractors participate in the construction and the purchaser is to co-ordinate the construction of the works as a whole (see the chapter "Choice of contract type"), it may be advisable to provide that the purchaser bears the risk of loss of or damage to the plant during construction. It may not be practical, or even possible, for each contractor to bear the risk in respect of a portion of the plant, since a particular portion may incorporate equipment and materials supplied by more than one contractor, or may

be constructed through the use of equipment and materials supplied by one contractor and services supplied by another contractor. However, if one of the contractors is to co-ordinate the construction (e.g. a semi-turnkey contractor), the risk of loss of or damage to the plant may be borne by him and not by the purchaser.

E. Consequences of bearing of risk

23. Where the contractor bears the risk of loss of or damage to equipment or materials supplied by him to be incorporated in the works, the plant during construction or the completed works until acceptance, he should be obliged to make good the loss or damage covered by the risk at his own expense with all possible speed. In order to make good the loss or damage, the contractor should at his own expense replace property which has been lost or repair property which has been damaged. Where the contractor bears the risk of loss of or damage to equipment or materials supplied by the purchaser, the purchaser should be obliged, if so requested by the contractor, to make good the loss or damage at the contractor's expense as soon as the purchaser can conveniently do so (e.g. taking into account his other commitments).

24. Where the purchaser bears the risk of loss of or damage to property supplied by the contractor, such loss or damage should not discharge him from his obligation to pay the price payable in respect of the lost or damaged property. However, if such loss or damage occurs during construction, the purchaser should be obliged to make good the loss or damage with all possible speed. Since, however, the property was supplied by the contractor, the purchaser may prefer to oblige the contractor to make good the loss or damage at the expense of the purchaser. This obligation should be limited only to cases where the purchaser asks the contractor to make good the loss or damage before the expiry of the guarantee period. The contractor should be entitled to compensation for all reasonable costs incurred by him for the purpose of making good the loss or damage. He should be obliged to make good the loss or damage as soon as he can conveniently do so (e.g. taking into account his other commitments). An alternative to this approach would be to give the purchaser the right to order the contractor to make good the loss or damage as a variation order. The provisions for adjustment of the price and extension of the time for construction in the case of variations would apply when the contractor makes good the loss or damage (see the chapter "Variation clauses").

F. Contractor's tools and construction machinery to be used for effecting construction

25. The contractor will bring tools and construction machinery to the site to be used only for effecting the construction. The risk of loss of or damage to such property should be borne by the contractor and should not pass to the purchaser. The contract may provide

that the tools and machinery may in some situations be used by the purchaser or someone employed by him for the construction. Even in these cases, however, it may be advisable that the risk be borne by the contractor, if the tools and machinery are used as provided for under the contract. However, if they are used by the purchaser without the consent of the contractor or in an inappropriate way, or if the purchaser is in delay in returning them, the risk should be borne by the purchaser. The purchaser should be obliged to make good to the contractor the financial consequences of loss of or damage to the tools and machinery.

[A/CN.9/WG.V/WP.13/Add.4]

Insurance

Summary

The contract should require property insurance and liability insurance (paragraphs 1 and 2). It should specify the risks which are to be insured against, the party who is obligated to provide the insurance, the parties and other entities who are to be named as insured parties, the amount of insurance, the applicable deductible or excess, and the period of time to be covered by the insurance.

The property insurance should insure against loss of or damage to the plant during construction and to the completed works (paragraphs 11 to 18), to equipment and materials to be incorporated in the works (paragraphs 19 to 22) and to the contractor's machinery and tools (paragraph 23). Where the contractor is to bear the risk of loss of or damage to the entire plant during construction and the completed works, and in some cases where the contractor is to be responsible for co-ordinating construction by other contractors, the contractor should be obligated to provide insurance covering the entire plant and works and to keep the insurance in force (paragraph 12). The contractor should be named as an insured party if he is to bear the risk of loss of or damage to the plant and works; the purchaser should also be named as an insured party if the risk of loss or damage may pass to him prior to acceptance (paragraph 13).

With respect to the risks to be insured against, it may be advisable for the contract to require a comprehensive policy insuring against loss or damage resulting from all perils, except those perils excluded by the policy. The contract should also specifically require insurance against loss or damage resulting from such of the excluded perils as may be relevant to the particular contract (paragraphs 14 and 15). The contract may require that the insurance compensate not only for loss of or damage to the plant and works, but also for losses such as lost profits and increased loan servicing costs. It should require that the insurance compensate for the costs of repairing or replacing lost or damaged portions of the plant or works, and professionals' fees connected therewith (paragraphs 17 and 18).

The contract may contain analogous requirements in respect of insurance covering equipment and materials to be incorporated in the works (paragraphs 19 to 22) and the contractor's machinery and tools (paragraph 23).

The liability insurance should insure against the contractor's liability for loss of or damage to the property of the purchaser or of a third person, and for injury to any person, arising out of the contractor's performance of the contract, including acts or omissions of his employees and sub-contractors, as well as liabilities under indemnities or other liabilities assumed by the contractor under the contract (paragraphs 24 to 32).

The contract may also require the contractor to provide specific types of liability insurance, such as products liability insurance (paragraph 25), professional indemnity insurance (paragraph 26), insurance against liabilities arising from the operation of vehicles (paragraph 28), and insurance to compensate employees for work-related injuries (paragraph 29). Liability insurance should be required to be in effect prior to the time when construction commences, and should cover loss, damage or injury occurring throughout the construction phase and the guarantee period (paragraph 31).

The contract should obligate the contractor to submit appropriate proof to the purchaser that insurance which the contractor is obligated to provide is in effect (paragraph 33). If the contractor fails to provide required insurance, the purchaser should be able to take out the insurance and to deduct the costs thereof from sums due to the contractor, or to recover these costs from the contractor (paragraph 34). If, due to non-co-operation by the contractor, the purchaser cannot take out insurance which the contractor has failed to provide, the purchaser should be able to terminate the contract (paragraph 35).

* * *

A. General remarks

1. Due to the risks of loss, damage and injury resulting from a large number of potential perils during the construction of industrial works, and the potential financial consequences of such risks, it is common for a works contract to require that insurance be taken out against these risks. Governments which are purchasers, as well as lenders, often require such insurance. This chapter deals only with insurance which the contract may or should obligate a party to provide. It does not deal with types of insurance which a party may wish to have, or is required by law to have, but which the contract ordinarily need not obligate a party to provide.

2. Works contracts usually contain provisions relating to:

(a) Property insurance, to insure the completed works, the plant during construction, equipment and materials to be incorporated in the works and the

contractor's machinery and tools against loss or damage. This insurance insures property owned by the insured party and in which he otherwise has an insurable interest (e.g. property in respect of which he bears the risk of loss or damage);

(b) Liability insurance, to insure the contractor against his liability for loss, damage or injury caused in connection with his performance of the contract, as well as his liability under indemnities granted by him in the contract to the purchaser.

3. The fact that a party has provided insurance covering certain risks should not constitute a limitation of the liabilities or obligations of that party under the contract, even if the contract requires him to insure against those risks. The contract should contain an express provision to this effect.

4. The insurance provisions in the contract should specify the risks which are to be insured against, as well as the party who is obligated to provide the insurance, the parties and other entities who are to be named as insured parties, the amount of insurance, the deductible or excess, if any, applicable to each risk (i.e. the amount of a financial loss which the insured must bear himself, the insurer compensating under the insurance policy only to the extent the loss exceeds such amount), and the period of time to be covered by the insurance. Due to the complex and often unique nature of industrial works projects, insurance coverage will usually have to be tailored to meet the particular circumstances of the project.

5. The parties should be aware that the type or amount of insurance which can be provided will be limited by what is available in the insurance market. Some coverage which a party might consider desirable may not be available. Other coverage may be obtainable only at a cost which may not be economically justified in a particular project. Therefore, in drafting insurance provisions, the parties should bear in mind whether it is possible to obtain contemplated coverage at reasonable rates.

6. The amount of insurance required by the contract and the scope of the risks insured against should not exceed those which are necessary or prudent under the circumstances of the project. Purchasers should be aware that even if the contractor provides and pays for insurance, the costs of insurance will usually ultimately be borne by the purchaser. For example, in a lump-sum contract, the costs of insurance provided by the contractor will be reflected in the price charged by the contractor; and in a cost-reimbursable contract, these costs will be borne directly by the purchaser. Excessive insurance required by the purchaser will unnecessarily increase the price which he must pay. Moreover, in a lump-sum contract, imposing excessive insurance costs on the contractor may tempt him to reduce other costs in order to maintain the attractiveness of his bid or his profit margin. Such a practice could adversely affect the quality of the works to be supplied to the purchaser. When it is contemplated that the contractor will be obligated to provide certain types of insurance, the

purchaser may wish to consider whether it would be financially advantageous for him to obtain the insurance himself, as well as the desirability of agreeing that the various types of insurance should be subject to deductibles or excesses as large as are prudent, taking into account the nature and magnitude of the risks in question.

7. It is advisable that the insurance programme for the plant during construction and the completed works be co-ordinated to the greatest extent practicable and possible. The existence of numerous separate policies covering different risks and different parties and issued by different insurers, perhaps in different countries, often results in duplication of insurance against some risks and gaps with respect to insurance against other risks. It is often desirable to have a single policy cover as many of the risks and parties as possible. If separate policies are necessary, it may be desirable for them to be issued by the same insurer. It is generally possible to achieve a higher degree of co-ordination in the insurance programme in a turnkey contract than when several contractors are involved.

8. The parties should be aware of any mandatory rules of law relating to insurance in connection with the construction of industrial works. For example, in some countries local law requires that insurance covering loss, damage or injury occurring in connection with the construction of works in those countries be taken out with insurers in those countries (see also para. 27, below).

B. *Property insurance*

9. The contract should require insurance against loss of or damage to the completed works, the plant during construction, equipment and materials to be incorporated in the works and the contractor's machinery and tools. This insurance should cover loss or damage arising from natural causes and from acts and omissions of persons for whom neither party is responsible.

10. Except to a limited extent, insurance against loss of or damage to the completed works, the plant during construction and equipment and materials will not compensate for the costs of repairing or replacing defective equipment or materials supplied by the contractor or of portions of the plant or works defectively constructed by him. In addition, the insurance usually will not insure against loss of or damage to the plant or works resulting from defective design. However, the insurance will often compensate for repair and replacement of portions of the plant and works and of equipment and materials other than those which are defective or are defectively designed or constructed. Loss or damage caused by defective design may be covered by professional indemnity insurance (see para. 26, below). It should be noted, however, that professional indemnity insurance normally covers only loss or damage resulting from negligent design, while the exclusion from property insurance of loss or damage resulting from defective design may extend

even to loss or damage resulting from non-negligent defects. Thus, coverage for loss or damage to the plant or works due to defective design will often be incomplete.

1. Insurance of plant during construction and completed works

11. The insurance covering the plant during construction and the completed works should be required also to cover temporary structures and structures ancillary to the works, such as administrative and maintenance facilities. The contract should require this insurance to cover the plant and the works until the works has been accepted by the purchaser. After acceptance the works should, of course, be covered by insurance taken out by the purchaser; however, the contract need not contain a provision to this effect.

12. In a turnkey contract, and in other types of contracts in which the contractor bears the risk of loss of or damage to the entire plant during construction and to the completed works prior to acceptance, the contract should obligate the contractor to provide insurance against loss or damage to the plant and works and to keep this insurance in force. Where a semi- or partial turnkey contract or separate contracts approach is adopted for the supply and construction of the works (see the chapter "Choice of contract type"), it is not desirable for each contractor to provide insurance covering only the portion of the plant and works supplied and constructed by him. This could result in the duplication of insurance costs and could present problems in administering a claim for loss or damage involving two or more contractors. In such cases, therefore, the purchaser should normally provide insurance against loss or damage covering the plant and works as a whole. However, when one contractor is to co-ordinate construction by the other contractors, he may be obligated to provide and keep in force such insurance until acceptance by the purchaser.

13. The contract should stipulate who are to be named as insured parties in the insurance policy. If the contractor is to bear the risk of loss of or damage to the plant during construction and the completed works prior to acceptance, he should be named as an insured party. Where the risk of loss or damage may pass to the purchaser prior to acceptance (see the chapter "Completion, take-over and acceptance"), the purchaser should also be named as an insured party. Where the purchaser is to bear the risk of loss of or damage to the entire plant during construction (see the chapter "Passing of risks"), he should be the insured party.

14. Different approaches may be adopted with respect to the risks required by the contract to be insured against by property insurance. One approach may be to specify in the contract that the insurance must insure against all loss or damage arising from any peril. The parties should be aware, however, that insurance satisfying such an all-encompassing requirement is unlikely to be available. Insurance policies, even those

designated as insuring against all risks, usually exclude risks of loss or damage arising from various perils.

15. Some insurers make available a comprehensive insurance policy which insures against loss or damage from all perils, with the exception of certain specifically excluded perils, such as wear and tear, explosion or mechanical or electrical breakdown (with respect to the portion of the plant or works immediately affected by such perils) and pressure waves caused by aircraft. Loss or damage from some of the excluded perils, such as loss or damage arising from the installation and use of equipment in the works (e.g. explosion and electrical or mechanical breakdown), may be insured against by special endorsements to the policy or under a separate policy, at additional cost. If the contract is to require that a comprehensive property insurance policy be provided, the parties should carefully consider whether the policy excludes any perils which present risks against which insurance should be provided, given the nature of the construction to be performed under the contract. It would be preferable for the contract to require a comprehensive property insurance policy and additional insurance against risks arising from perils excluded from the comprehensive policy than to attempt to itemize in the contract the specific perils which are to be covered by insurance.

16. Under the contract risks arising from certain perils (so-called "excepted risks") may be excluded from the risks borne by the contractor (see the chapter "Passing of risks"). If such an approach is adopted in the contract, it would be desirable, if possible, for the insurance which the contractor is obliged to provide to insure even against risks arising from such excluded perils. Otherwise, the purchaser would have to obtain separate insurance for these risks. Such division of insurance could lead to gaps in or unnecessary duplication of insurance, and higher insurance costs. Moreover, in the event of loss or damage, a time-consuming and costly dispute could arise as to whether the loss or damage was insured against under the insurance taken out by the contractor or under that taken out by the purchaser.

17. The insurance of the plant during construction and the completed works will normally compensate for loss or damage to the property. It will usually not compensate for other types of losses. For example, it will not compensate for losses such as lost profits and increased loan servicing costs resulting from the fact that, due to the loss of or damage to the plant, the works could not be completed on time. However, such losses may be covered by a special endorsement or policy, and if the purchaser desires to have such coverage, it should be expressly required by the contract.

18. The contract should require the property insurance to compensate for the cost of repairing or replacing the lost or damaged portions of the plant or works. It should also require the insurance to compensate for costs connected with the repair or replacement, such as

architects', surveyors', lawyers' and engineers' fees, and costs connected with dismantling and removing the damaged portions. The amount of insurance required should be sufficient to cover all of the various types of compensation to be provided by the insurance. The contract may therefore take into account the effects of inflation in determining the amount of insurance.

2. *Insurance of equipment and materials to be incorporated in works*

19. The contract should expressly require insurance against loss of or damage to equipment and materials to be incorporated in the works. The contract should require this insurance to be in effect from the time the equipment and materials are shipped to the site until the time they are incorporated in the works. When the equipment and materials are incorporated, they will be covered by the insurance of the plant and works discussed in the previous subsection. In some cases it may be desirable to require the coverage to begin earlier than at the time of shipment (e.g. when the equipment or materials have been identified to the contract). Such a requirement may be desirable, for example, if loss of or damage to equipment or materials on the contractor's premises prior to shipment would adversely affect the financial resources of the contractor and thus his ability to perform the contract.

20. It is desirable for a single insurance policy to insure the equipment and materials for the entire period referred to in the previous paragraph. If the equipment and materials were to be insured under separate policies for individual stages within this period (e.g. transit, storage off-site and storage on-site), incomplete or overlapping coverage could result. Moreover, if insurance during each stage were provided under separate policies, it might be necessary in the event of loss or damage to identify the stage at which the loss or damage occurred. This could be difficult or impossible in many cases. Insurance covering equipment and materials during the entire period is available in some of the comprehensive policies described in para. 15, above. In the event that it is not possible to obtain insurance for the entire period in a single policy (e.g. if the comprehensive policy will not insure the equipment and materials before or during transit), the contract should require the separate policies providing insurance during the various individual stages to be taken out with the same insurer.

21. In a turnkey contract, and in other types of contracts in which the risk of loss of or damage to equipment and materials remains with the contractor until they are incorporated in the works, the insurance described in this subsection should be provided and kept in force by the contractor, with the contractor named as the insured party. In contracts in which the risk with respect to some equipment or materials is to pass to the purchaser prior to their incorporation in the works, both the contractor and the purchaser should be named as insured parties.

22. The discussion in paras. 14-18, above, concerning the risks to be insured against and the amount of insurance which should be required is equally applicable to insurance of equipment and materials.

3. *Insurance of contractor's machinery and tools*

23. In particular projects it may be desirable to obligate the contractor to insure against loss of or damage to his machinery and tools during shipment to the site, while they are stored off-site and while they are on the site. If they are to be insured, they should be covered against the same risks as are the works, plant during construction and equipment and materials to be incorporated in the works. It may be possible for such coverage to be included in a comprehensive insurance policy insuring the plant and works.

C. *Liability insurance*

24. The contract should obligate the contractor to insure against his liability for loss of or damage to the property of the purchaser or of a third person, and for injury to any person, arising out of the contractor's performance of the contract, including acts or omissions of his employees and sub-contractors. In addition, the contractor should be obligated to insure against any indemnities or other liabilities which he assumes under the contract (e.g. undertakings by him to indemnify the purchaser against the purchaser's liability to third parties). A contractor will often maintain blanket insurance for some of these liabilities in his ordinary course of business. This insurance should not be duplicated; rather, the contractor should provide such additional insurance as is needed to cover fully the risks and term, and to meet the amount, required by the contract.

25. Liability insurance will often not be available to insure the contractor against his liability to the purchaser for defects in the works due to a failure of the contractor to perform his obligations under the contract (e.g. liability for the supply of defective equipment or materials or for defective construction). However, some liability insurance policies may insure against the contractor's liability for loss of or damage to portions of the plant not being worked on, resulting from acts or omissions of the contractor in the course of construction. The contract may require such insurance. The contract should obligate the contractor to insure against liability for loss of or damage to the property of a third person, and for injury to any person, due to a defect in the works constructed by him. While such coverage is usually included in a liability insurance policy, it may be necessary for the contractor to obtain such coverage under a separate products liability insurance policy.

26. If the contractor is to provide architectural, design or similar professional specialist services, the contract should obligate him to take out professional indemnity insurance. This insurance insures against the liability of the supplier of such specialist services for loss or

damage caused to the purchaser or to third persons or their property as a result of the negligent performance of such services.

27. Laws in some countries hold contractors liable for structural defects in the works for the first ten years of the life of the works and make insurance against such liability mandatory. However, while insurance against liability to third parties for loss and damage resulting from such defects may be available, insurance against liability to the purchaser for defects in or collapse of the works may be difficult to obtain.

28. Liability for loss of or damage to property and for personal injury arising out of the operation of motor vehicles owned or used by the contractor and sub-contractors may have to be insured against separately. Such insurance, which is mandatory in many countries, should be specifically required by the contract. So, too, should coverage for liability arising out of the operation of aircraft and watercraft, if they are to be used in the construction of the works.

29. Many legal systems have statutory schemes with respect to compensation for injury to workmen on the site and other employees of the parties and of sub-contractors. Some of these schemes require employers to provide insurance to compensate employees for work-related injuries. In other legal systems, workmen may be left to their remedies under general legal principles governing injury and damages. The contract should obligate the contractor to provide such insurance as is required under relevant laws. If insurance is not required, the contractor should be obligated to insure against his liability for injury to his employees and those of his sub-contractors. Moreover, if under relevant laws insurance to compensate for injury suffered by employees is required in a certain amount but an employee is able to recover an amount in excess of the required amount of insurance, insurance against this excess exposure should be required, in addition to the insurance required by law. In some legal systems an injured employee of a contractor or a sub-contractor may be able to recover compensation from the purchaser. Therefore, the contract should obligate the contractor to name the purchaser, as well as the contractor, as insured parties in the insurance described in this paragraph (see also para. 32, below).

30. The amounts of insurance coverage to be provided by the types of insurance described in this section will depend on the magnitude of the risks present in a particular project, the extent to which it is economically prudent to insure against these risks, and other factors such as the amount of a particular type of coverage which must be provided by law.

31. The contract should require the contractor to have the insurance discussed in this section in effect prior to the time when he or any sub-contractor commences construction on the site. It should cover loss, damage or injury occurring throughout the construction phase and the guarantee period.

32. Because of the possibility that a single incident resulting in loss, damage or injury to a third person could give rise to claims against several or all of the participants in the construction (e.g. purchaser, contractor and sub-contractors), it is usually prudent for each of these participants to be insured against their liabilities for such loss, damage or injury. The most desirable way to accomplish this would be for all participants to be named as insured parties in one policy. If they were to be insured under separate policies, and if the loss, damage or injury suffered by a third person could have been caused by more than one participant, the various participants and their insurance companies may become involved in time-consuming and costly litigation to establish which participant should ultimately bear the loss or the extent to which the participants should contribute to the compensation payable to the claimant. If it is not possible for all participants to be insured under one policy, all of the policies covering the various participants should be taken out with the same insurer. Such requirements should be expressly stipulated in the contract.

D. Proof of insurance

33. In order for the purchaser to be able to satisfy himself that the contractor has performed his obligations to provide insurance and to keep it in force, the contract should obligate the contractor to produce to the purchaser, when the purchaser requires him to do so, duplicates of the insurance policies or certificates of insurance, showing all of the relevant terms of the policies, and receipts for the payment of premiums.

E. Failure of contractor to provide insurance

34. The contract should provide that if the contractor fails to provide or keep in force any insurance which he is required to provide, the purchaser may obtain the insurance. In a lump-sum contract, the purchaser should be able to deduct the amounts paid by him for such insurance from sums due to the contractor or, alternatively, to recover such sums from the contractor. In a cost-reimbursable contract, the purchaser should be able to deduct from sums due to the contractor, or recover from the contractor, the amount by which what the purchaser had to pay for the insurance exceeds what the cost of the insurance would have been had the contractor fulfilled his obligation to obtain it or keep it in force.

35. The contract should provide that if, due to the failure of the contractor to co-operate with the purchaser or the insurer, the purchaser is unable to obtain or keep in force certain types of insurance which the contractor was obliged but failed to provide or keep in force, the purchaser may terminate the contract. In addition, the contract should provide for the contractor to be liable to the purchaser for any loss or damage suffered by the purchaser as a result of the contractor's failure.

[A/CN.9/WG.V/WP.13/Add.5]

Sub-contracting

Summary

The term "sub-contracting" as used in this guide refers to the employment by the contractor of a third party to perform certain of the contractor's obligations under the contract (paragraph 1). It is desirable for the contract to contain provisions dealing with the permissible scope of sub-contracting, the selection of sub-contractors and other aspects of sub-contracting.

As a general characteristic of sub-contracting in a works contract no contractual relationship should be created between the purchaser and the sub-contractor, and the contract should clearly confirm this principle. Moreover, the contract should specify that the contractor is to be liable to the purchaser for the performance of the contractor's obligations by sub-contractors to the same extent as the contractor would be liable if he failed to perform the obligations himself. The contract should also require the contractor to indemnify the purchaser against any liability which the purchaser may have to bear towards a third person as a result of an act or omission of the sub-contractor, to the same extent that the contractor would be obligated to indemnify the purchaser if the contractor himself had committed the act or omission (paragraph 5).

In some cases it may, however, be desirable for the contract to permit the purchaser to communicate directly with sub-contractors. Thus, the contract might obligate the contractor to authorize a sub-contractor to act on his behalf in settling with the purchaser certain issues connected with the performance by the sub-contractor.

In some cases the contractor may be expected to sub-contract the performance of most or all of his obligations. In others, it may be advisable for the contract to prohibit the contractor from sub-contracting the performance of all or part of his obligations (paragraphs 7 and 8).

With regard to the selection of sub-contractors, the parties might consider three basic approaches. The choice of a particular approach would depend upon the interest of the purchaser in influencing the selection of a sub-contractor (paragraphs 9 to 12). The first approach is the selection of sub-contractors by the contractor without any participation by the purchaser in the selection.

Under the second approach, prior to entering into the contract the parties would either agree upon particular sub-contractors to be employed by the contractor or agree upon a list of acceptable sub-contractors from which the contractor would select his sub-contractors (paragraphs 13 and 14).

Under the third approach, the contract would not specify the sub-contractors whom the contractor may

engage. Rather, a sub-contractor might be chosen by the contractor subject to the consent or objection of the purchaser (paragraphs 15 to 19).

The sub-contractor may, alternatively, be nominated by the purchaser, subject to a right of the contractor to object if the nominated sub-contractor does not agree to terms of the sub-contract which sufficiently protect the contractor's interests, or if the contractor has other reasonable objections to the sub-contractor (paragraphs 20 to 23). However, the nomination system should be used with caution, and with a full understanding of the procedures and contractual provisions and their consequences (paragraphs 24 and 25).

Normally, the purchaser will not be able to claim directly against the sub-contractor for non-performance or defective performance. If the purchaser wishes the sub-contractor to undertake particular obligations, such as confidentiality or guarantee obligations, and if the purchaser wishes to be able to claim directly against the sub-contractor for a violation of such obligations, the contract should provide mechanisms to accomplish this (paragraph 26).

The contract might permit the purchaser to pay the sub-contractor directly if the contractor has failed to pay sums due to the sub-contractor. The making of such direct payments might be conditioned on the purchaser's delivering to the contractor a demand for proof that payment due to a sub-contractor has been made, and the contractor's failure within a specified period of time thereafter either to deliver such proof to the purchaser or to deliver to the purchaser an explanation constituting sufficient grounds for his failure to make such payment (paragraphs 27 to 31).

* * *

A. General remarks

1. The term "sub-contracting" as used in this guide refers to the employment by the contractor of a third party to perform certain of the contractor's obligations under the contract. The term includes, for example, third parties who are employed by the contractor for the erection of the works or the supply of other services on site, and those who produce equipment for the contractor to be incorporated in the works.

2. It is common for a contractor to employ sub-contractors to perform certain of his obligations under a works contract. A contractor may not possess the expertise, personnel, equipment and financial resources to perform by himself all of the specialized work for which he is responsible under the contract. Even if a contractor is able to perform all of his contractual obligations himself, he may be required by regulations in force in the country where the works is to be constructed to employ local sub-contractors to perform some types of work. In some countries, contracts for the construction of industrial works are entered into by a foreign trade organization, or similar entity, and this

entity sub-contracts for the performance of the construction obligations under the contract.

3. It is desirable for a works contract to contain provisions dealing with the permissible scope of sub-contracting, the selection of sub-contractors and other aspects of sub-contracting. Without such provisions, under some legal systems a contractor might be able to sub-contract more liberally than would be desirable from the point of view of the purchaser; under other legal systems his ability to sub-contract without the express consent of the purchaser might be restricted. In formulating such provisions, the parties should be aware of any mandatory rules in the law applicable to the contract and legal rules in force in the country where the works is to be constructed.

4. As a general characteristic of sub-contracting in a works contract, no contractual relationship should be created between the purchaser and the sub-contractor. The contract should clearly confirm this principle in respect of all cases of sub-contracting. The contract should expressly and clearly provide that the contractor is to be liable to the purchaser for any failure of a sub-contractor to perform an obligation of the contractor to the same extent that the contractor would be liable if he failed to perform the obligation himself. Preserving the contractor's liability for the performance of his obligations under the contract will preserve the purchaser's right to redress for defective or non-performance of an obligation of the contractor. It will also prevent the obtaining of such redress by the purchaser from being hampered by an inability to prove whether the defect resulted from a failure of performance by the contractor or by a sub-contractor.

5. In addition to providing that the contractor should be liable to the purchaser for a failure by a sub-contractor to perform, the contract should obligate the contractor to indemnify the purchaser against any liability which the purchaser may have to bear towards a third person as a result of an act or omission of a sub-contractor, to the same extent that the contractor would be obligated to indemnify the purchaser if the contractor himself had committed the act or omission.¹

¹*Illustrative provisions*

"(1) All sub-contractors employed by the contractor are those of the contractor alone, and no provision of this contract shall be interpreted or applied so as to give rise to or imply the existence of a contractual relationship between the purchaser and any sub-contractor, except to the extent that this contract expressly provides otherwise.

"(2) The contractor shall be liable to the purchaser for any failure of a sub-contractor to perform an obligation of the contractor under this contract to the same extent that the contractor would be liable if he performed such obligation himself. No sub-contracting by the contractor or ability of the contractor to sub-contract shall diminish or eliminate the responsibility of the contractor for the complete performance of his obligations in accordance with this contract.

"(3) The contractor agrees to indemnify the purchaser against and save him harmless from any liability which the purchaser may have to bear towards a third person as a result of an act or omission of a sub-contractor, to the same extent that the contractor would be obligated to indemnify the purchaser against and save him harmless from such liability resulting from an act or omission of the contractor himself."

6. The insulation of the purchaser from the sub-contractor, however, does not necessarily mean that there should be no communication between these two entities. In some cases it may be desirable for a purchaser to be able to communicate directly with a sub-contractor, particularly when technical matters are involved, to enable such matters to be efficiently discussed and understood by the purchaser and sub-contractor. The contract might therefore obligate the contractor to authorize a sub-contractor to act on his behalf in settling with the purchaser certain issues connected with the performance by the sub-contractor.

B. Right of contractor to sub-contract

7. In some situations, it may be expected that the contractor will sub-contract the performance of most or all of his obligations, for example, where the contractor supplies the technology for the works and the purchaser relies on the contractor's expertise in selecting and supervising sub-contractors to construct the works incorporating this technology. In other cases, it may be advisable for the contract to prohibit the contractor from sub-contracting the performance of all of his contractual obligations. The extent and nature of the obligations which the contractor might be permitted to sub-contract should depend upon the extent to which, because of the purchaser's reliance on the expertise and reputation of the contractor, or because of the nature of an obligation, the purchaser expects the obligation to be performed by the contractor himself. For example, in a turnkey contract a contractor may be selected because of his ability to supply a particular major component of the works. In such a case, the contractor should not be permitted to have this component supplied by a sub-contractor. In addition, a purchaser may wish to restrict or prohibit the contractor from sub-contracting if the purchaser is to supply the design and he wants to protect the confidentiality of the design.

8. There are two different approaches by which the contract may delimit the scope of permissible sub-contracting. Under one approach, the contract could specify those obligations which the contractor cannot sub-contract and provide that all other obligations may be sub-contracted, subject to the other provisions of the contract (e.g. those discussed in the following section). Under the other approach, the clause could prohibit the sub-contracting of any of the contractor's obligations, except those obligations specified in the clause which the contractor may sub-contract, again subject to the other provisions of the contract. The decision as to which approach to adopt may depend on the nature of the contract. In a turnkey contract, for example, in which it is usually expected that a relatively large number of the contractor's obligations will be sub-contracted as compared with other types of contracts, it may be preferable to specify those obligations, if any, which cannot be sub-contracted, and to permit other obligations to be sub-contracted.

C. Selection of sub-contractors

9. For cases in which the contractor is permitted to sub-contract, the following basic approaches to the selection of sub-contractors might be considered by the parties. Under the first approach, sub-contractors would be selected by the contractor without any participation by the purchaser in the selection. Under the second approach, sub-contractors would be agreed upon by the parties prior to entering into the contract, and these sub-contractors would be stipulated in the contract. Under the third approach, specific sub-contractors would not be stipulated in the contract; rather, either the contractor would select the sub-contractors subject to the approval of the purchaser, or the purchaser would select the sub-contractors subject to a right of the contractor to object to the selection. It is possible for the contract to provide different approaches to the selection of sub-contractors to perform different obligations.

10. The parties might wish to adopt the first approach for cases in which the purchaser has little or no interest in the selection of the sub-contractors, for example, the selection of sub-contractors to supply certain routine and non-critical services.

11. In many cases, however, the purchaser has a concrete interest in the selection of a sub-contractor. First, he may be interested in having the sub-contracted obligations performed by a firm that possesses the expertise and resources needed to perform the obligations satisfactorily. Second, in contracts in which the price charged by a sub-contractor will directly affect the price payable by the purchaser to the contractor, such as in a cost-reimbursable contract, the purchaser will be interested in having the sub-contracted obligations performed at the most reasonable price. Third, the purchaser may wish to be assured that particular equipment to be installed be of certain standard which can only be met by some sub-contractors. Fourth, the purchaser may wish to be able to restrict the contractor to the employment of local sub-contractors, or he may be obliged to do so by local law. Fifth, due to arrangements with foreign financing organizations, the purchaser may be obliged to engage in a certain amount of sub-contracting with sub-contractors from the country of the organization.

12. These circumstances may be accommodated by having the contract provide for the purchaser to be involved in the selection of a sub-contractor. The degree and nature of the purchaser's involvement may vary, depending on the type of contract between the contractor and purchaser and the importance to the purchaser of being able to exercise control over the cost and quality of the performance of the obligation to be sub-contracted and the identity of the sub-contractor. Purchasers should be aware, however, that the ability to compel a contractor to sub-contract with a particular sub-contractor could be more costly for a purchaser, since the contractor will have to include in his price his costs of exercising increased supervision over a sub-contractor with whom he may not be familiar, as well

as an increment to account for his increased risk resulting from his being liable to the purchaser in respect of such a sub-contractor.

13. If possible, and in particular if the item or service to be supplied by a sub-contractor is critical for the works, it is desirable for sub-contractors to be agreed upon by the parties prior to entering into the contract, and to be specified in the contract (i.e. the second approach referred to in para. 9, above). This will avoid disputes as to the choice of sub-contractors in particular instances. It will also avoid interruptions of the work and financial consequences which may arise in cases in which one party does not agree to a sub-contractor proposed by the other party. Moreover, such an approach might help to avoid "bid-shopping" by the contractor after the contract has been awarded. Under this practice, a contractor uses a bid which he has obtained from a sub-contractor, and upon which his own contract price is based, to try to obtain lower bids from other sub-contractors and possibly force a lower bid from the first sub-contractor. If the contractor is successful in procuring a lower price from the sub-contractor (which, in most lump-sum contracts, will not benefit the purchaser), the sub-contractor may have an incentive to perform less satisfactorily in order to prevent his profit margin from being reduced.

14. Under the second approach, the contract might specify a particular sub-contractor to perform a certain obligation. Alternatively, the contract might include a list of acceptable sub-contractors who have been agreed to by the purchaser and the contractor prior to entering into the contract, and the sub-contractor would be selected by the contractor from the list. The ability of the purchaser to agree to a sub-contractor or a list of sub-contractors might be facilitated if the contractor were to obtain bids from proposed sub-contractors and present them to the purchaser together with details of their past work records. However, the solicitation of bids by the contractor could result in extra expenses to him which would ultimately have to be borne by the purchaser. Moreover, in contracts other than cost-reimbursable contracts, the contractor may be reluctant to reveal to the purchaser bids submitted by sub-contractors.

15. When the contract does not specify the sub-contractors whom the contractor may engage, there are various mechanisms to provide for involvement by the purchaser in the selection of a sub-contractor (i.e. the third approach referred to in para. 9, above). One such mechanism is for the contract to provide that the contractor may not sub-contract without the consent of the purchaser. Either such consent could be required to be given in writing by the purchaser to the contractor, or the purchaser could be deemed to have given consent if the contractor delivers to the purchaser a written request to sub-contract with a particular sub-contractor, and the purchaser does not deliver to the contractor a written objection to such sub-contracting within a specified period of time after receiving the request. Under either approach, the written notice to be given by the contractor should include the name and address

of the proposed sub-contractor and the work to be performed by him. In contracts in which the price charged by the sub-contractor will directly affect the price to be paid by the purchaser (e.g. cost-reimbursable contracts and some lump-sum contracts), the notice should also include the price to be charged by the sub-contractor. The contract may also provide that any objection by the purchaser to sub-contracting proposed by the contractor must be based upon reasonable grounds.²

16. One possible problem with the approaches mentioned in the preceding paragraph is that if a contractor proposes a sub-contractor who fails to meet with the approval of or is objected to by the purchaser, and the contractor must find and propose a new sub-contractor, the work could be interrupted, possibly resulting in financial consequences to both parties. It may be noted, however, that cases in which the contractor proposes a sub-contractor who does not meet with the approval of the purchaser are not very frequent.

17. If a dispute arises as to whether the purchaser's grounds for objecting to the sub-contractor proposed by the contractor are reasonable, two approaches are possible. Under one approach, the dispute could be submitted to dispute settlement proceedings, with no sub-contractor employed until the dispute is resolved. The construction would be interrupted to the extent that it could not be performed without a sub-contractor having been employed. If the purchaser's objection were found to be reasonable, the contractor would be obligated to choose another sub-contractor and to bear the financial consequences of the interruption of construction. If the purchaser's objection were found to be unreasonable, the contractor could be permitted to sub-contract in accordance with his notice to the purchaser, and the purchaser could be required to bear the financial consequences of the interruption of construction.

18. The parties may, however, consider an alternative approach, which would minimize the interruption of construction. Under this approach, the contractor would be obligated immediately to deliver to the purchaser a new notice of sub-contracting which meets the purchaser's objection. The dispute concerning the reasonableness of the purchaser's objection to the sub-contracting proposed in the first notice could be submitted for settlement immediately or at some later time. The pendency of such proceedings would not postpone the employment of a sub-contractor acceptable to the purchaser. If in the dispute settlement pro-

ceedings the purchaser's objection were found to be unreasonable, the purchaser could be required to bear the financial consequences of any interruptions in construction or other financial consequences, such as those arising from a failure of the sub-contractor to perform satisfactorily, resulting from the contractor's acting in accordance with the purchaser's objection. If the purchaser's objection were found to be reasonable, the contractor could be required to bear these consequences.

19. In certain types of contracts, e.g. cost-reimbursable contracts, the contractor might be required to solicit bids from a certain number of sub-contractors for the performance of the obligations to be sub-contracted and to submit to the purchaser bids which the contractor would be prepared to accept. The sub-contractor could be selected from these bidders either by the purchaser or by the contractor, subject to the consent of the purchaser. This mechanism may be more appropriate for the selection of sub-contractors to provide equipment or services which are relatively routine, or which are not fundamental to a special design or other services. With respect to highly specialized or integral items, there may not exist a range of sub-contractors from whom bids could be solicited.

20. Even more extensive involvement by the purchaser in the selection of sub-contractors may be provided by having the purchaser himself select a sub-contractor and require the contractor to execute a sub-contract with him. This, in essence, is the system of "nomination", which is common in certain parts of the world and which can also be found in some international contracts for the construction of industrial works.

21. Under the nomination procedure, the purchaser identifies and negotiates with prospective sub-contractors to perform obligations which are specified in the contract as being subject to the nomination procedure. These negotiations may take place before the contract is entered into. If so, it may be possible to include in the contract the essential terms of a sub-contract to be concluded by the contractor, including the price. In a lump-sum contract, if a price for the sub-contracted work is not established at the time of entering into the contract, an estimated price for this work may be set forth in the contract, and the contract price may be increased or decreased by the difference between the estimated price and the actual price for the sub-contracted work. In any event, the contract would obligate the contractor to enter into a sub-contract only with the sub-contractor nominated by the purchaser.

22. Under this system, in order to protect the contractor against being obligated to enter into a relationship with a sub-contractor which is unduly prejudicial to his interests, the contract may allow the contractor to refuse to enter into a sub-contract on certain grounds. These grounds may include the following:

(a) If, with respect to the materials, equipment or services to be provided by the sub-contractor, the sub-contractor will not undertake toward the contractor obligations and liabilities of the same scope and extent

²*Illustrative provision*

"The contractor shall deliver to the purchaser written notice of his intention to sub-contract, which shall include the name and address of the proposed sub-contractor, (and) a precise description of the work to be performed by him [and the price to be charged by him]. The contractor shall be permitted to sub-contract in accordance with such notice after the expiration of . . . days following the delivery thereof to the purchaser, unless within the said . . . days the purchaser delivers to the contractor an objection, specifying reasonable grounds, to the proposed sub-contractor, the obligations to be sub-contracted, or the price to be charged by the sub-contractor."

as are imposed on the contractor towards the purchaser, including obligations and liabilities with respect to quality, timing, guarantees, and financial amounts of liability;

(b) If the sub-contractor will not agree to indemnify the contractor against and save him harmless from any liability which the contractor incurs towards the purchaser or a third person as a result of acts or omissions of the sub-contractor;

(c) If the contractor has any other reasonable objection to sub-contracting with the sub-contractor. This could cover situations in which, for example, the contractor has previously had unsatisfactory experience with the sub-contractor, or in which the sub-contractor's financial situation prejudices his ability to perform satisfactorily. This ground could be stipulated in addition to, or as an alternative to, the more concrete grounds in (a) and (b), above.

23. If the nomination system is adopted, the parties should consider what should occur if the contractor properly refuses to enter into a contract with a sub-contractor nominated by the purchaser. The purchaser might be obligated to re-nominate, or the contractor might be given the task of finding a new sub-contractor subject to the approval of the purchaser to be procured according to mechanisms which should be specified in the contract. In either case, the purchaser should bear the financial consequences of an interruption of work which may arise from these procedures. For cases in which the contractor refuses to enter into a sub-contract because the sub-contractor refuses to incorporate terms in the sub-contract designed to protect the contractor *vis-à-vis* the purchaser, the contract might obligate the contractor to enter into the sub-contract if the purchaser agrees to a reduction in the scope of the obligations of the contractor to the purchaser, so that they match the obligations of the sub-contractor to the contractor.

24. There are various advantages to the purchaser of a mechanism such as the nomination system. It enables the purchaser to choose a sub-contractor and gives the purchaser a large measure of control over the price and other terms under which the sub-contracted obligations will be performed. It also enables the purchaser to make use of a particular design, equipment or service supplied by a certain sub-contractor. In addition, it is a way for the purchaser to ensure that sub-contracts are awarded to local firms. These benefits may be achieved by the purchaser without himself having to enter into a contractual relationship with the sub-contractor. However, this mechanism should be used with caution and with a full understanding of the procedures involved, as well as the contractual provisions and their consequences. There are various pitfalls which could be encountered in the use of the nomination system, and these should be dealt with by appropriate contractual provisions. For example, unless clearly negated by the contract, implications might be drawn from the degree of the purchaser's involvement in the selection of a contractor that contractual rights and obligations arise directly between the sub-contractor and the purchaser,

or that the contractor's liability for the performance of the sub-contractor is limited. The contract should make it clear, therefore, that the sub-contractor's contractual relationship is with the contractor alone, and that the contractor is liable to the purchaser for the performance of the sub-contractor (see para. 4, above).

25. Another problem which could be encountered with the nomination system is that if the sub-contractor abandons his performance of the sub-contract, or if the sub-contract is terminated, a question may arise as to which party is to bear the burden and costs of engaging a new sub-contractor to complete the unfinished work. The contract should make it clear that the contractor is obligated to provide at his own expense a new sub-contractor to complete the work, subject to the approval of the purchaser to be procured according to mechanisms which should be specified in the contract. The contractor should also be responsible for financial consequences arising from the interruption of the work and the process of engaging a new sub-contractor.

D. Ability of purchaser to claim directly against sub-contractor

26. A sub-contractor who is not a party to the contract between the contractor and the purchaser will have no contractual obligations towards the purchaser. However, in some situations the purchaser may wish the sub-contractor to undertake certain obligations (e.g. to preserve the confidentiality of the design or to guarantee his work), and to be able to claim directly against the sub-contractor for a violation of these obligations. The purchaser may procure such obligations and the ability to enforce them directly against the sub-contractor in the following manner. First, the contract would impose such obligations on the contractor. In addition, the contractor would be obligated to obtain the same obligations from the sub-contractor, either by a provision in the contract obligating the contractor to do so, or by the purchaser's conditioning his consent to a sub-contractor proposed by the contractor on the contractor's obtaining such obligations from the sub-contractor. An additional provision would be included in the contract by which the contractor assigned to the purchaser the contractor's rights against the sub-contractor for a violation of the obligations, if such an assignment is permitted by applicable law.

E. Payment for performance by sub-contractors

27. The contract should contain no obligation on the part of the purchaser to pay the sub-contractor directly. With no contractual relationship between the purchaser and the sub-contractor, the sub-contractor will have to obtain payment from his contracting party, the contractor. Under the pricing structure of the contract, either the cost to the contractor of the services of his sub-contractors will be provided for in the contract price (e.g. as is done in most lump-sum contracts), or the actual cost of such services will be payable by the purchaser to the contractor (e.g. as is done in a cost-

reimbursable contract, or in a lump-sum contract if the contract price may be increased by the amount by which the actual cost of such services exceeds the estimated price for such services set forth in the contract).

28. There may, however, be instances in which the purchaser wishes to pay a sub-contractor directly, such as when the contractor has failed to pay a sum previously due to the sub-contractor and the smooth progress of the contract programme is threatened by a reluctance of the sub-contractor to continue to work. The contract might therefore authorize the purchaser to pay a sub-contractor directly and recover the sums so paid from the contractor or otherwise be credited for such payments. Unless such authorization is expressly included in the contract, a purchaser who pays a sub-contractor directly will place himself in peril, since he will remain liable to pay the same sum to the contractor. The contract should also make it clear that such direct payments by the purchaser are made on behalf of the contractor in order to avoid the implication of the existence of a contractual relationship between the purchaser and the sub-contractor.

29. The contract should authorize the purchaser to demand proof from the contractor that payment due to a sub-contractor has been made. If, within a specified period of time after delivery of such a demand to the contractor, the contractor does not deliver such proof to the purchaser, or deliver to the purchaser a written explanation of the grounds for not making such payment, the purchaser may be authorized to make the payment to the sub-contractor if the grounds for the contractor's non-payment are not sufficient, and to recover the amount of the payment from the contractor or otherwise be credited for such payments.

30. The method by which the purchaser recovers from the contractor or is credited the amount of his direct payment to the sub-contractor may depend upon the payment structure of the contract. In a lump-sum contract, the purchaser should be able to deduct the amount of his payment from the contract price to be paid to the contractor. However, if a lump-sum contract stipulates an estimated sum in respect of the sub-contracted work but provides that the contract price may be adjusted in accordance with the actual price of the sub-contracted work (see para. 21, above), the purchaser should be able to deduct at least to the extent of the estimated sum stipulated in the contract. Where the contract price has already been fully paid to the contractor by the purchaser, the purchaser should be entitled alternatively to claim reimbursement from the contractor.

31. In a cost-reimbursable contract, if the purchaser pays the sub-contractor directly on behalf of the contractor in respect of the sub-contracted work, no adjustment need be made as between the contractor and the purchaser, since the contractor will not have incurred a cost for the sub-contracted work which is to be reimbursed by the purchaser. However, under the terms of some sub-contracts, a contractor's obligation

to pay a sub-contractor may accrue only after the contractor has received payment from the purchaser. In such cases, the purchaser should be authorized if he deems it necessary to pay the sub-contractor directly after the purchaser has paid the contractor for work performed by the sub-contractor but the contractor has failed to pay the sub-contractor. The purchaser should then be entitled to deduct the amount of his direct payment to the sub-contractor from sums which later become due to the contractor, or to claim reimbursement from the contractor.

[A/CN.9/WG.V/WP.13/Add.6]

Security for performance

Summary

Each party to a works contract may seek security against failure of performance by the other. The forms of security which the purchaser usually obtains are guarantees (paragraphs 4-32), the right not to pay the full sum due to the contractor until proof of satisfactory performance by him (paragraphs 33-36), and security interests in property (paragraph 43).

A guarantee provides that, if a failure of performance by the contractor occurs, a third party (the guarantor) will be responsible for that failure in the manner described in the guarantee (paragraph 4). Two kinds of guarantees may be required by purchasers—performance guarantees (paragraphs 5-8) and repayment guarantees (paragraphs 5 and 9). Performance guarantees, which are security for due performance by the contractor, usually take one of two forms. Under one form, commonly known as a first demand guarantee, the guarantor undertakes that he will pay the purchaser a specified sum of money as compensation upon the bare assertion of the purchaser that the contractor has failed to perform (paragraphs 7 and 14). Under the other form, commonly known as a performance bond, the guarantor undertakes that, upon proof by the purchaser that the contractor has failed to perform, the guarantor will at his option either himself rectify the failure, or will engage another contractor to do so, or will pay a sum of money as compensation (paragraphs 7 and 15).

A repayment guarantee is a security that an advance payment made by the purchaser to the contractor will be repaid by the contractor. Such a guarantee usually takes the form of an undertaking by the guarantor to pay the purchaser a specified sum of money if the contractor does not repay the advance (paragraph 9).

In regard to guarantees which he requires, the purchaser should consider whether he should specify the guarantors who are acceptable to him. The purchaser often specifies that the guarantors should be institutions in his own country, as it will be easier for him to enforce guarantees given by such institutions. Contracts often provide that a guarantee may be given by an

institution in the contractor's country, but that the guarantee must be confirmed by an institution in the purchaser's country (paragraphs 10-11).

The link between the purchaser and the guarantor is established under the guarantee. However, the contract should prescribe the nature and terms of the guarantee which the contractor is obligated to provide (paragraph 12). The guarantee may be independent or accessory. A typical example of an independent guarantee is a first demand guarantee, while a typical example of an accessory guarantee is a performance bond (paragraphs 13-15). Each form has its advantages and disadvantages (paragraphs 16-18).

Guarantees may be furnished by the contractor at the time of the conclusion of the contract, or the contract may provide that the guarantee is to be furnished within a short period of time after the conclusion of the contract. In the latter event, the contract should determine the purchaser's remedies if the guarantee is not furnished (paragraph 19).

The liability of the guarantor is normally limited to a specified monetary value. If the works contract contains certain limitations of the contractor's liability for failure of performance, the parties may wish to include such limitations in the guarantee (paragraphs 20-21). The parties should also determine the currency in which sums are to be paid under the guarantee. The parties may wish to consider whether the amount of the guarantee should be reduced in certain circumstances. In regard to a performance guarantee, reduction may be justified after the purchaser receives some assurance of satisfactory completion of construction (paragraph 22).

Under many legal systems, variations of a contract discharge the liability of a guarantor. Accordingly, the contract generally regulates the effect of variations on the guarantee (paragraphs 24-27). The contract should also regulate the duration of the guarantee. It is in the interest of the purchaser that the guarantee be maintained till the contractor's obligations are discharged. The guarantor and the contractor are interested in fixing a clear expiry date for the guarantee (paragraphs 28-31).

The contract may formulate the payment conditions so as to provide that full payment of the price is to be made only upon satisfactory completion of construction by the contractor (paragraphs 33-36).

The contractor may obtain security for the payment of sums due to him in the form of an irrevocable letter of credit (paragraphs 37-42) and security interests in property (paragraph 43). The parties should agree on certain issues connected with the letter of credit (e.g. the currency of payment, and the documents to be presented to the bank to obtain payment) (paragraphs 41-42).

Each party often wishes to create by agreement security interests in his favour over property of the other party. There are, however, certain disadvantages connected with such security interests (paragraph 43).

* * *

A. General remarks

1. Each party to a works contract is aware that failure of performance by the other party may cause him considerable loss. While a party will have contractual remedies under the works contract against the other party for compensation in the event of such failure, he may wish in addition to have other remedies to protect himself against the failure. For this purpose, each party may wish to arrange for some form of security upon which he can call in place of or in addition to his contractual remedies under the works contract. Such security may take various forms. It may take the form of a promise of a third person of substantial financial standing to pay a sum of money upon failure of performance. It may take the form of an undertaking by such a third person to cure or complete defective or incomplete construction. Both these arrangements are generally known as guarantees. It may also consist of a right in respect of certain funds, or over property belonging to the other party, which may be exercised so as to obtain compensation.

2. The parties should in their contract set forth the forms of security to be provided by each party and the consequences of a failure to do so. The furnishing of security entails costs for the party who furnishes it. The costs may vary with the value and form of the security. Parties should therefore determine the degree of protection that they reasonably require, and avoid over-protection. Where a guarantee is to be provided, the contract and the guarantee would be separate legal instruments. However, their provisions should be harmonized, and the contract terms should not derogate from the rights to which a party is entitled under a guarantee.

3. The law applicable to the security may not be the same as that applicable to the contract. The law applicable to the security may mandatorily regulate certain aspects of the security, such as its form, its period of validity and, where the security consists of a guarantee, the rights arising from retention of the guarantee document. It will also determine the relationship between the security and the works contract. The parties should take account of the law which will be applicable to the security in determining the nature of the security to be obtained. Where the security consists of a guarantee, it may also be necessary to take account of the law of the country of the guarantor, which may mandatorily regulate the guarantor's business, e.g. require registration and impose ceilings on the amounts which may be guaranteed.

B. Security for performance by contractor

1. Guarantees

4. Guarantees provide that, if a specified failure of performance by the contractor occurs, a third person (the guarantor) will be responsible for that failure in the manner described in the guarantee. The term "guarantee" is not universally used to describe such agreements, and the terms "bond", "suretyship agreement" and "indemnity" are often used. In some countries, banks are prohibited from issuing guarantees. However, "stand-by letters of credit", having the same function as guarantees, may be issued by banks. A stand-by letter of credit is a letter of credit opened by a bank at the request of the contractor in favour of the purchaser. Under the terms of such letters of credit, the purchaser would be entitled to claim a certain sum of money from the bank in the event of failure of performance by the contractor.¹ The guarantees dealt with in this chapter are distinct from guarantees of quality. The latter type of guarantee consists of contractual undertakings by a party as to the quality of his performance, e.g. that equipment or materials to be supplied by him will be of a stated quality.

5. Guarantees as security for the purchaser are frequently used in the following contexts:

(a) As security that a contractor who has submitted a tender will not withdraw his tender before the date set in the invitation to tender for awarding the contract, and as security that he will conclude a contract if the contract is awarded to him and will submit the performance guarantee specified in the invitation to tender. Such guarantees, commonly known as tender guarantees, are dealt with in the chapter "Invitation to tender and negotiation process";

(b) As security against loss that a purchaser might suffer if a contractor who has concluded a contract fails to perform in accordance with the contract. Such guarantees are commonly known as performance guarantees;

(c) As security that an advance payment made by the purchaser to the contractor will be repaid to the purchaser. Such guarantees are commonly known as repayment guarantees.

(a) Performance guarantees: function

6. A purchaser who is entering into a works contract will seek a contractor who possesses the financial as well as the technical and operational resources needed to complete the work. Often, however, a purchaser may not have full information concerning a prospective foreign contractor's finances, the extent of his other work commitments (which could interfere with his performance), his prior performance record, or other factors bearing on the contractor's ability to see the

project through to completion. Furthermore, unforeseen factors occurring after the conclusion of the contract may affect the contractor's ability to perform the contract. Invitations to tender and works contracts therefore often provide that performance guarantees must be furnished by the contractor, so that remedies may be available to satisfy the liabilities of the contractor in the event of failure of performance. Requiring a performance guarantee may also tend to prevent contractors who are unreliable or have no financial resources from tendering. Guarantor institutions generally make careful inquiries about the contractors whom they are asked to guarantee and will normally only provide guarantees if they have reasonable grounds for believing that the contractor can successfully perform the contract.

7. Performance guarantees are generally of two types. Under one type, hereinafter referred to as monetary performance guarantees, the guarantor only undertakes to pay the purchaser funds up to a stated limit, to satisfy the liabilities of the contractor in the event of the contractor's failure of performance. Such guarantors are often commercial banks. Under the other type, the guarantor at his option undertakes either himself to cure or complete defective or incomplete construction effected by the contractor, or to obtain another contractor to cure or complete the construction, and also to compensate for other losses caused by the failure of performance. The value of such undertakings is limited to a stated amount. The guarantor generally also reserves the option to discharge his obligation by payment of money to the purchaser up to a specified sum. This type of guarantee is generally given by specialist guarantee institutions, like bonding and insurance companies, and is hereinafter referred to as a performance bond. The purchaser may find it advisable to permit a tendering contractor to submit either type of guarantee, as the contractor may have business relations with a guarantor institution willing to provide one or the other of these types to the contractor at an inexpensive rate. From the point of view of the purchaser, each form of guarantee has certain advantages and disadvantages (see paras. 16-18, below).

8. In all works contracts, the contractor undertakes not merely to complete the construction, but also to cure defects notified to him by the purchaser before the expiry of the period of the quality guarantee (see the chapter "Failure to perform"). The contractor's performance during this guarantee period may be secured either by the same performance guarantee which covers performance up to completion, or by a separate performance guarantee, sometimes called a maintenance guarantee. In the account that follows, it will be assumed that the parties wish to provide for a single performance guarantee. The considerations set forth below as relevant to a performance guarantee would also be relevant to a separate maintenance guarantee.

(b) Repayment guarantees: function

9. In order to assist the contractor in the purchase of materials and equipment and in mobilization, a purchaser

¹The nature of stand-by letters of credit is described in a report of the Secretary-General, "Standby letters of credit" (A/CN.9/163) (Yearbook . . . 1979, part two, II, B).

often makes an advance payment to the contractor of part of the price. This advance payment would be set off against sums due to the contractor for his supply of services, materials and equipment. To protect the purchaser against failure of repayment by or bankruptcy of the contractor, the contract may provide that the contractor must furnish a guarantee of repayment in case such events occur.

(c) *Choice of guarantors*

10. The purchaser may wish to decide whether he should specify the guarantors whom he is willing to accept. The advantage of specification is that those guarantors can be specified who are of proved financial standing and have a satisfactory record in settling claims. The disadvantage of specification is that this may exclude contractors with no access to the specified guarantors or may prevent contractors from using guarantors with whom they have a close relationship and who are willing to provide guarantees inexpensively.

11. A possible approach is to provide that in the first instance the contractor can propose a guarantor of his choice. If the proposed guarantor is not acceptable to the purchaser, however, the contractor should be obliged to replace him with one who is acceptable. In this connection, the purchaser should also consider whether he should stipulate that only guarantees furnished by financial institutions in the country of the purchaser are acceptable. In some countries, governmental regulations may provide that only guarantees furnished by local financial institutions may be accepted. The advantage of stipulating that guarantees should be given by institutions in the country of the purchaser is that such guarantees can be more easily enforced and the sums due more easily collected. The disadvantages are that local institutions may charge more for guarantees and also may not be prepared to give certain forms of guarantees, such as a performance bond. Furthermore, local institutions may not be prepared to give guarantees on behalf of foreign contractors who are not known to them. A possible approach is to permit the contractor to use non-local guarantors, but to require that a local financial institution confirm the guarantee. In certain countries, the financial standing of institutions providing guarantees is checked and approved by governmental agencies, and limits are placed on the sums they may guarantee. The purchaser may wish to provide that, where a guarantor is proposed from such a country, the guarantor should be an approved institution.

(d) *Nature of guarantor's obligation*

12. While the contract between the contractor and the purchaser can prescribe the nature and terms of the guarantee which the contractor is obligated to provide, it is the guarantee itself which establishes the link between the guarantor and the purchaser. Accordingly, the legal relationship between the purchaser and guarantor is governed by the provisions of the guarantee and the law applicable to it. The contract between the purchaser and

the contractor should expressly state that the purchaser can resort to the guarantee only if there is in fact a failure of performance by the contractor. The contract may, however, also impose certain limitations on the purchaser's right to resort to the guarantee (e.g. by providing that before resorting to the guarantee the contractor should be given notice of his failure of performance, and that a specified time period must elapse after delivery of such notice before a claim can be made under the guarantee).

13. In form, a performance guarantee is closely connected with the underlying works contract, i.e. the guarantor has to pay, or arrange for performance, upon failure of performance by the contractor under the works contract. The terms of the guarantee, however, may make the guarantee in practice independent of the works contract, or accessory to it.

14. A typical example of a guarantee which in practice is independent of the obligations in the underlying works contract is a first-demand guarantee, under which the guarantor has to make payment on demand by the purchaser. The purchaser is entitled to recover under the guarantee upon his bare assertion that the contractor has failed to perform. Whether in fact there is a failure under the works contract, or whether there is liability for such failure on the part of the contractor, is irrelevant to the guarantor's liability.

15. The guarantee would be accessory when the obligation of the guarantor is more closely linked to liability of the contractor for failure of performance under the works contract. The nature of the link may vary under different guarantees, e.g. the purchaser may have to establish the contractor's liability by producing an arbitration award which holds that the contractor is liable, or the guarantor may be entitled to rely on certain defences which the contractor may have in respect of his failure of performance. Performance bonds usually have such an accessory character.

16. The advantage to a purchaser of a first-demand guarantee is that he is assured of prompt recovery of funds under the guarantee, without proof of failure of performance by the contractor or of the extent of his loss. A purchaser may frequently lack the expertise required to prove the contractor's failure of performance. Furthermore, certain guarantors, in particular commercial banks, prefer first-demand guarantees as the conditions under which their liability to pay accrues are clear, and they are not involved in disputes between the purchaser and the contractor as to whether or not there has been failure of performance in respect of the works contract. The costs to a purchaser resulting from obtaining a first-demand guarantee, however, may be more than those resulting from obtaining an accessory guarantee, since the contractor may wish to include in the price the cost of insurance which he wishes to take out against the risk of recovery by the purchaser under the guarantee when there has been in fact no failure of performance by the contractor, or the potential costs of an action for damages against the purchaser in case of such recovery. In addition, as a reflection of the higher risk of payment

borne by a guarantor under a first-demand guarantee, the amount of the guarantee would normally not exceed a very limited percentage of the contract price. A disadvantage of a first-demand guarantee to the contractor is that, if there is a recovery under the guarantee in breach of the terms of the works contract, there may be difficulties and delays in the recovery of damages from the purchaser, whereas the loss caused to the contractor may be immediate, since the guarantor may immediately after payment reimburse himself from the assets of the contractor.

17. Under a performance bond, the purchaser must prove that the contractor has failed to perform, and the extent of the loss suffered by him. Furthermore, all defences available to the contractor if he were sued for failure of performance are available to the guarantor. Accordingly there is a possibility that the purchaser will face a protracted dispute when he makes a claim under the guarantee. However, the monetary limit of liability of the guarantor may be considerably higher than under a first-demand guarantee, as a reflection of the lesser risk of payment borne by the guarantor. A performance bond may also be advantageous if the purchaser cannot conveniently arrange for the cure or completion of construction himself, but would need the assistance of a third person to arrange for such cure or completion. Where, however, the contract involves the use or transfer of a technology known only to the contractor, cure or completion by a third person may not be feasible, and a performance bond under which the guarantor may employ a third person for cure or completion may have no advantage over a monetary performance guarantee.

18. It may be noted, however, that the manner in which guarantees are to be formulated is a matter for agreement between the purchaser, the contractor and the guarantor. The parties may wish to provide that the guarantee to be furnished is to be neither completely accessory nor a pure first-demand guarantee. Thus, they may wish to provide for the furnishing of a guarantee under which a sum of money is payable only if the demand is made in writing and is accompanied by a specified written statement which identifies or describes the failure of performance which has resulted in the demand. The guarantor would, however, be under no duty to investigate the correctness of the statements made regarding the failure of performance. It would also be possible, again, to provide for a guarantee under which money is payable only if the demand of the purchaser is accompanied by a certificate of the engineer, or an independent third person acting under an expeditious dispute settlement mechanism, deciding that there has been failure of performance by the contractor. Furthermore, the common interest of both parties in the successful completion of the contract serves to discourage an abuse of rights under guarantees.

(e) *Time of furnishing guarantee*

19. Disputes between the parties as to the wording and nature of guarantees to be furnished may be minimized if the guarantee becomes effective and the contract is concluded at the same time. In order to

achieve this, the purchaser may stipulate in his invitation to tender the guarantors whom he would be prepared to accept and set forth a form of the guarantee which he requires. Alternatively, the parties may wish to provide that the guarantee is to be furnished within a short specified period of time after the conclusion of the contract (e.g. because this is less expensive). In order to assure the purchaser that a contractor to whom a contract is awarded will furnish the required performance guarantee, the tender guarantee to be furnished may provide that it is not to expire until the performance guarantee is furnished (see the chapter "Invitation to tender and negotiation process"). Another approach is for the invitation to tender to require that a tender should be accompanied by a certificate from an institution qualified to be a guarantor to the effect that, if the contract were awarded to the tenderer, the institution would be prepared to give a performance guarantee of the kind described in the invitation to tender. If it is agreed that the guarantee is to be furnished after the conclusion of the contract, the parties should in the contract agree on the rights of the purchaser in case the guarantee is later not furnished (e.g. that he may terminate the contract and recover damages).

(f) *Extent of liability under guarantee*

20. The liability of the guarantor is normally limited to a specified monetary value. This value may be determined as a percentage of the contract price or advance payment. The exact percentage may be determined by an assessment of the risks of non-performance involved and a consideration of the limits which guarantors usually observe when providing guarantees for the type of works in question. A requirement of a very large guarantee sum may prevent smaller enterprises from bidding, as they might be unable to obtain guarantees for such sums. The parties should also determine the currency in which sums are to be paid under the guarantee. In the case of a repayment guarantee, this may be the currency of the advance payment. In the case of a performance guarantee, it may be the currency in which the contract price is to be paid. If the price is to be paid in more than one currency, a particular currency may have to be specified.

21. The works contract may contain certain limitations of the contractor's liability for failure of performance, such as an exclusion of liability for "indirect" loss. In such cases, the parties may wish to include in the guarantee such limitations of liability to the same extent as they appear in the works contract. However, where a guarantee is accessory (e.g. in the case of a performance bond), the law applicable to the guarantee may provide that the extent of liability of the guarantor is co-extensive with that of the contractor. If, therefore, under the applicable law the contractor's liability is limited, the guarantor's liability would be similarly limited. If, however, the applicable law is not clear on this issue, it would be preferable for the guarantee to deal with it.

22. The parties may also wish to consider whether the amount of the guarantee should be reduced after contract performance has progressed to a certain stage. In respect of performance guarantees, one approach may be not to provide for any reduction. This may be justified by the view that a failure of performance may occur at the last stage of construction, requiring for its compensation the full amount of the guarantee. Another approach may be to provide for a reduction upon acceptance of the works by the purchaser, since the mechanical completion tests and performance tests held prior to acceptance (see the chapter "Completion, acceptance and take-over") will have shown that performance has been in accordance with the contract. However, a reduction merely upon the acceptance of a stage of the work may not be justified, since failures of performance at subsequent stages may require for their compensation the full amount of the guarantee. Furthermore, failures of performance such as delay tend to occur after construction is well under way, and not at the early stages.

23. In order to give the purchaser comprehensive security, it would generally be advisable for liability under the guarantee to arise upon any form of failure of performance to which the guarantee relates. Thus, in respect of a performance guarantee, liability under the guarantee should arise upon non-performance, defective performance and delay in performance. The guarantor should be liable to pay for costs and damages caused by the failure of performance.

(g) *Effect of variation of contract*

24. A significant issue in connection with guarantees is the effect of a variation of the scope of obligations under the contract (see the chapter "Variation clauses") on the obligations of the guarantor. Since these variations will change the contractor's obligations under the contract, they will be of concern to the guarantor. A substantial extension or increase of the contractor's responsibilities may increase the risk to which the guarantor is exposed. In the case of a performance bond, such an extension or increase of the contractor's responsibilities may affect the guarantor's capability to cure or complete defective or incomplete construction. In some legal systems, unless otherwise provided in the guarantee, an alteration of the underlying contract could operate to release the guarantor; or the guarantor may be obligated only to the extent of the contractor's obligations at the date of issuance of the guarantee. In view of the frequency with which variations are made to a works contract, parties should expressly address this issue in the guarantee.

25. Different approaches may be adopted. Since the amount of the guarantor's liability is limited to a stated amount and the duration of the guarantee is also limited (see paras. 28-32, below), the guarantor may be prepared to bear his risk as so limited even if variations to the contract may to some extent alter that risk. If this approach is adopted, the guarantee should expressly state that it remains valid as limited by its original terms despite any variations to the contract. Another approach may be to provide that the guarantee is to

remain valid as limited by its original terms despite any variations, provided that such variations do not collectively increase the contract price by more than a stated percentage. If the stated percentage is exceeded, the consent of the guarantor is to be required if the guarantee is to remain valid. Yet another approach may be to provide that, if the contract is varied, the guarantee is to remain valid only in respect of contractual obligations which are not varied. In respect of obligations which are varied, the consent of the guarantor is to be required if the guarantee is to remain valid.

26. The provisions in the contract concerning variations and those in the guarantee concerning the effect of variations on the guarantee should be in harmony. Thus, if the contract gives the purchaser a unilateral right to order certain variations, the provisions in the guarantee should not be such that, in the event of any variation, the guarantee becomes invalid or does not apply to failure to perform the obligations as varied. Such lack of harmony would deter the purchaser from exercising his right to order variations.

27. Provisions which would maintain the validity of the guarantee in accordance with its original terms may not suffice to protect the purchaser. The variation of the contract may extend the period for performance or increase the liabilities of the contractor in the event of a failure of performance. The parties may therefore wish to provide that in such cases the contractor is obliged to procure from the guarantor appropriate modifications to the expiry date, amount and other relevant terms of the guarantee. The costs of such modifications should be borne by the party bearing the costs of the variations to the construction (see the chapter "Variation clauses").

(h) *Duration of guarantee*

28. It is in the interest of the purchaser that the guarantee should cover the full period during which any obligation of the contractor guaranteed may be outstanding. In respect of a performance guarantee, the guarantee should cover not only the period during which the construction is to be effected, but also the period of the quality guarantee (see para. 8, above, and the chapter "Failure to perform").

29. It is in the interest of the guarantor that the guarantee have a clear expiry date, when he will cease to bear the risks under the guarantee. Banks, in particular, will generally insist that such a fixed date be specified in monetary performance guarantees furnished by them. One technique used to delimit the period covered by a guarantee is for the guarantee to provide that claims may not be made under the guarantee after a specified date. In such cases, the parties may wish at the time of the conclusion of the contract to agree upon a fixed date to be inserted in the guarantee, calculated on the basis of an estimated period of time for the completion of the performance of the obligations to be guaranteed. However, while such a fixed date may

satisfy the interests of the guarantor, it may create difficulties for the purchaser and the contractor, since for various reasons the period of time for which the guarantee is required may extend beyond the fixed date (e.g. because of delay in performance by the contractor, or by the operation of clauses dealing with exempting impediments). Accordingly, where the contractor has not satisfactorily fulfilled his contractual obligations by the expiry date of the guarantee, the contract should obligate the contractor, upon the request of the purchaser, to arrange for an extension of the period of validity of the guarantee for a further period necessary for the satisfactory fulfilment of the contractor's obligations.

30. The guarantor under a performance bond may not insist on a fixed expiry date. However, because of the accessory character of the bond, the guarantor would cease to be liable when the contractor has discharged his obligations even if no specified expiry date had been provided in the performance bond. Another approach may be for the performance bond to provide that claims may not be made after the date of the final payment under the contract to the contractor. Such a final payment would only be made after the purchaser is satisfied that the contractor has fulfilled his obligations, and accordingly it would be reasonable to exclude claims against the guarantor after that date.

31. As regards a repayment guarantee, providing for expiry of the guarantee on a fixed date may present the same difficulties as in respect of a performance guarantee. When the guarantor does not insist on a fixed expiry date, a possible approach may be to provide for the guarantee to expire when the contractor has supplied services and equipment in the value of the guarantee amount. Such supply may be proved either by a certificate by the engineer or purchaser to that effect or by documents evidencing supply (e.g. invoices or transport documents certified by the purchaser, or site receipts from the purchaser's representatives).

32. Parties may also wish to deal with the situation where the contract is terminated prior to the last date for making claims under the guarantee. The parties may wish to provide that claims may be made under the guarantee subsequent to the termination, provided they are made as a consequence of failures of performance by the contractor.

2. Security for performance created through payment conditions

33. The payment conditions of the contract may be formulated so as to create a security available to the purchaser against failure of performance by the contractor. Under a works contract, payment is usually made in instalments as the work progresses. One method of formulating the payment schedule is to provide that an engineer or other independent third

party is to estimate the value of the performance effected by the contractor at specified stages of the construction and to provide that only the estimated value less a specified percentage is to be payable to the contractor. Accordingly, even upon completion of construction (see the chapter "Completion, acceptance and take-over") the contractor would not receive the full contract price. The full price would usually only be payable when the purchaser is satisfied that the works contains no defects and operates in accordance with the contract.

34. The advantage to a purchaser of a security created in this manner is that, upon a failure of performance by the contractor, he can utilize the sum not paid without recourse to a third party. A disadvantage is that, as the sum not paid only increases as construction progresses, it is an inadequate security during the early stages of construction. It is also possible that some contractors may experience a shortage of funds to finance the construction because they do not receive the full estimated value of the work done by them, and are forced to borrow money as a result. In such cases the costs of such borrowing may be incorporated by the contractor in the price quoted.

35. In fixing the percentage to be deducted from the estimated value to determine the amount payable at each stage, the parties should take into account several factors, e.g. the other security available to the purchaser, the extent of the estimated value, and the costs to the contractor occurring as a result of the deduction. Parties may feel that after the difference between the estimated value and the sum actually payable reaches a specified amount, the purchaser has adequate security. They may then wish to provide that, after that amount is reached, the full estimated value is to be payable for the work done. Another approach may be to provide that, when such difference reaches a specified amount, the percentage to be deducted from the estimated value should be reduced.

36. The contract will provide the procedures by which the contractor should satisfy the purchaser that the works contains no defects and operates in accordance with the contract (see the chapter "Inspection and tests", and the chapter "Completion, acceptance and take-over"). Payment of the balance outstanding from the full contract price after completion should be linked to the carrying out of these procedures. Thus, the contract may provide that a specified part of the balance outstanding is to be payable on acceptance. The remaining part may be payable upon the lapse of a specified period of time after the expiry of the quality guarantee period, provided the purchaser has no claims against the contractor at that point in time. The parties may also wish to provide that, on acceptance, the full balance outstanding should be payable to the contractor, provided the contractor furnishes a first-demand performance guarantee under which such outstanding balance may be claimed by the purchaser.

C. *Security for payment by purchaser*

37. The parties may wish to consider whether there should be some security for the performance of the main obligation of the purchaser, i.e. the payment of the price. When the construction of the works is financed by an international lending agency or other reputable institution, the contractor may have sufficient assurance that payment will be made for construction effected. Furthermore, since the payment conditions under a works contract usually provide that payment is to be made in instalments as the work progresses, the contractor has the option of suspending construction if an instalment is not paid. If, however, the contractor wishes to have security, the parties may wish to provide for payment under an irrevocable letter of credit.

38. Such a letter of credit consists of an irrevocable written undertaking by a bank (the issuing bank) given to the contractor at the request of the purchaser, to effect payment up to a stated sum of money within a prescribed time-limit and against stipulated documents.²

39. The parties may wish to determine the bank which is to issue the letter of credit. The undertaking of any recognized bank to pay may normally be regarded as sufficient security. The contractor may, however, obtain greater security if the contract requires the letter of credit to be confirmed by a bank in the contractor's country. Under such a confirmation, the confirming bank accepts a liability equivalent to that of the issuing bank. The contractor can recover payment under such a confirmed letter of credit without facing difficulties created by exchange control restrictions in the purchaser's country. However, requiring such confirmation would increase the costs of the purchaser. Parties should also agree on the time when the letter of credit is to be opened. Opening the letter of credit concurrently with the conclusion of the contract would create increased security for the contractor.

40. The terms of payment in the contract (e.g. currency of payment, amount of instalments payable, and time for payment) should be harmonized with the payment terms under the letter of credit. The parties should consider how the amount payable under the letter of credit should be specified (for example, an amount may be specified sufficient for the payment of any one of the instalments of the price payable under the payment schedule, such amount to be automatically made up to its original amount after each payment, until the full contract price is paid—the so-called revolving letter of credit). The terms of payment under the letter of credit should be agreed taking into account the commercial practices of banks in relation to letters of credit and the costs of the different possible arrangements. In all cases the letter of credit would provide for a maximum amount payable under it.

41. The parties in their contract should clearly agree on the documents against which the bank is to make payment and the wording and data content of these documents. Such documents would normally evidence the supply of the services, equipment or materials in respect of which the payment is made and may accordingly be of different types (e.g. engineer's certificates evidencing the progress of construction, transport documents, or site receipts by the purchaser's representatives in respect of the supply of equipment or materials).

42. It is in the interest of the contractor that the letter of credit should cover the full period during which any payment obligation of the purchaser may be outstanding. Banks will generally insist that a letter of credit should have a fixed expiry date. Determining such an expiry date may present difficulties. While the time schedule in the contract may specify a date for final payment, such date may be postponed for various reasons (e.g. delay in performance by the contractor, or exempting impediments preventing construction or payment). A possible approach may be to fix the expiry date by adding to the date for final payment specified in the contract a reasonable period for possible postponements of the date of final payment.

D. *Security interests in property*

43. In addition to the methods of providing security for performance considered above, the parties may consider the possibilities offered by the creation of security interests in property. Such security interests may be created independently of the agreement of the parties by the operation of mandatory provisions of the applicable law (e.g. a contractor who supplies labour and materials for construction may be given a security interest in the works constructed as security for payments due to him). Parties may wish to ascertain the extent to which security interests may be created by operation of law, and their rights under such security interests. In addition, parties may wish to create by agreement security interests for their protection. Mandatory legal rules may apply, regulating the manner in and the extent to which such security interests may be created. Under many legal systems, such security interests suffer from certain disadvantages (e.g. slowness in the procedures for realizing the collateral, obscurity as to the rules governing priority between different creditors, and the overriding effect of bankruptcy laws if the debtor becomes bankrupt). Furthermore, in the circumstances attending a works contract, certain forms of security may not afford a high degree of protection. Thus, a purchaser who obtains a security interest over the construction machinery of the contractor may find that after a certain period of use the machinery is of very little value, and a contractor who obtains a right to sell equipment supplied by him which has become the property of the purchaser may find that the value which may be realized by a sale of such equipment in the country of the purchaser is small.

²Such credits are usually governed by the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce. These Uniform Customs and Practice set forth rules relating to the opening and operation of letters of credit. The latest revision of the Uniform Customs and Practice (ICC document No. 400) is expected to be in force from 1 October 1984.

B. Seventh session of the Working Group on the New International Economic Order

1. Report of the Working Group on the New International Economic Order on the work of its seventh session (New York, 8-19 April 1985) (A/CN.9/262)^a

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Introduction

1. At its eleventh session, the United Nations Commission on International Trade Law decided to include in its work programme a topic entitled "The legal implications of the new international economic order" and established a Working Group to deal with this subject.¹ At its twelfth session, the Commission designated member States of the Working Group.² At its thirteenth session, the Commission decided that the Working Group should be composed of all States members of the Commission.³ The Working Group consists, therefore, of the following States: Algeria, Australia, Austria, Brazil, Central African Republic, China, Cuba, Cyprus, Czechoslovakia, Egypt, France, German Democratic Republic, Germany, Federal

Republic of, Guatemala, Hungary, India, Iraq, Italy, Japan, Kenya, Mexico, Nigeria, Peru, Philippines, Senegal, Sierra Leone, Singapore, Spain, Sweden, Trinidad and Tobago, Uganda, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United Republic of Tanzania, United States of America and Yugoslavia.

2. At its first session, the Working Group recommended to the Commission for possible inclusion in its programme, *inter alia*, the harmonization, unification and review of contractual provisions commonly occurring in international contracts in the field of industrial development.⁴ The Commission, at its thirteenth session, agreed to accord priority to work related to these contracts and requested the Secretary-General to undertake a study concerning contracts on the supply and construction of large industrial works.⁵

3. The study⁶ prepared by the secretariat was examined by the Working Group at its second and third sessions.⁷ At its third session, the Working Group requested the

^aFor consideration by the Commission, see *Report*, chapter IV, (part one, A, above).

¹Report of the United Nations Commission on International Trade Law on the work of its eleventh session, *Official Records of the General Assembly, Thirty-third Session, Supplement No. 17 (A/33/17)*, para. 71.

²Report of the United Nations Commission on International Trade Law on the work of its twelfth session, *Official Records of the General Assembly, Thirty-fourth Session, Supplement No. 17 (A/34/17)*, para. 100.

³Report of the United Nations Commission on International Trade Law on the work of its thirteenth session, *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17 (A/35/17)*, para. 143.

⁴A/CN.9/176, para. 31.

⁵See footnote 3, above.

⁶A/CN.9/WG.V/WP.4 and Add.1-8; A/CN.9/WG.V/WP.7 and Add.1-6.

⁷A/CN.9/198, paras. 11-80, and A/CN.9/217, paras. 13-129.

secretariat, pursuant to a decision of the Commission at its fourteenth session,⁸ to commence the drafting of a legal guide on contractual provisions relating to contracts for the supply and construction of large industrial works.⁹ The Legal Guide is to identify the legal issues involved in such contracts and to suggest possible solutions to assist parties, in particular from developing countries, in their negotiations.¹⁰

4. At its fourth session the Working Group examined a draft outline of the structure of the Legal Guide and some sample draft chapters prepared by the secretariat¹¹ and requested the secretariat to proceed expeditiously with the preparation of the Legal Guide.¹² At its fifth session,¹³ the Working Group discussed some additional draft chapters and a note on the format of the Legal Guide.¹⁴ At its sixth session,¹⁵ the Working Group discussed further draft chapters.¹⁶

5. The Working Group held its seventh session in New York from 8 to 19 April 1985. All members of the Working Group were represented, with the exception of Algeria, the Central African Republic, Nigeria, Sierra Leone, Singapore, Trinidad and Tobago, Uganda and the United Republic of Tanzania.

6. The session was attended by observers from the following States: Argentina, Bulgaria, Canada, Chile, Democratic People's Republic of Korea, Dominican Republic, Ecuador, Finland, Gabon, Greece, Holy See, Honduras, Indonesia, Iran (Islamic Republic of), Mozambique, Netherlands, Oman, Poland, Qatar, Republic of Korea, Switzerland, Thailand and Turkey.

7. The session was also attended by observers from the following international organizations:

(a) *United Nations organs*

United Nations Industrial Development Organization
United Nations Institute for Training and Research

(b) *Specialized agencies*

World Bank

(c) *Intergovernmental organizations*

Asian-African Legal Consultative Committee
European Economic Community
Inter-American Development Bank

(d) *International non-governmental organizations*

International Bar Association
International Chamber of Commerce
International Federation of Consulting Engineers

8. The Working Group elected the following officers:

Chairman: Leif SEVON (Finland)*

Rapporteur: Jelena VILUS (Yugoslavia)

9. The Working Group had before it for examination six draft chapters of the Legal Guide on drawing up international contracts for construction of industrial works: "Price" (A/CN.9/WG.V/WP.15/Add.1), "Consulting engineer" (A/CN.9/WG.V/WP.15/Add.2), "Transfer of technology" (A/CN.9/WG.V/WP.15/Add.3), "Transfer of ownership of property" (A/CN.9/WG.V/WP.15/Add.4), "Applicable law" (A/CN.9/WG.V/WP.15/Add.5), "Construction on site" (A/CN.9/WG.V/WP.15/Add.6), a revised draft outline of the structure of the Legal Guide (A/CN.9/WG.V/WP.15/Add.7), the revised draft chapters "Choice of contracting approach" (A/CN.9/WG.V/WP.15/Add.8), "Completion, take-over and acceptance" (A/CN.9/WG.V/WP.15/Add.9), and "Procedure for concluding contract" (A/CN.9/WG.V/WP.15/Add.10).

10. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Consideration of draft chapters of the Legal Guide on drawing up international contracts for construction of industrial works.
4. Other business.
5. Adoption of the report.

11. The Working Group proceeded to discuss the documents before it in the order presented below.

Consulting engineer¹⁷

12. It was generally agreed that the Guide should stress the importance of consistency between the provisions of the works contract dealing with the consulting engineer and the contract between the purchaser and the consulting engineer. It was suggested, however, that the Guide should specify that the works contract could not deal with the relationship between the purchaser and the consulting engineer. A suggestion was made that the Guide should point out that some international lending institutions and the rules of some legal systems might prohibit the professional who performed the feasibility study from serving as the consulting engineer under a works contract, since his conclusions with respect to the feasibility of the project could be influenced by the prospect of his providing services in connection with the construction of the works.

⁸Report of the United Nations Commission on International Trade Law on the work of its fourteenth session, *Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17)*, para. 84.

⁹A/CN.9/217, para. 130.

¹⁰See footnote 8, above.

¹¹A/CN.9/WG.V/WP.9 and Add.1-4.

¹²A/CN.9/234, paras. 51 and 52.

¹³A/CN.9/247.

¹⁴A/CN.9/WG.V/WP.9/Add.5 and A/CN.9/WG.V/WP.11 and Add.1-4 and 6-9.

¹⁵A/CN.9/259.

¹⁶A/CN.9/WG.V/WP.11/Add.4 and 5 and A/CN.9/WG.V/WP.13 and Add.1-6.

*The Chairman was elected in his personal capacity.

¹⁷A/CN.9/WG.V/WP.15/Add.2.

13. With respect to the functions to be performed by the consulting engineer, a suggestion was made that the "General remarks" section should indicate that such functions would vary depending on the nature of the works contract. It was further suggested that paragraph 1 should avoid an implication that a consulting engineer might engage in contract management.

14. Various views were expressed with respect to the exercise of independent functions by the consulting engineer. According to one view, it was not realistic to expect that a contractor would agree to the exercise of certain independent functions (e.g. dispute settlement, or determination of the existence of hardship or of rights to suspend or terminate the contract) by a consulting engineer who had been selected by the purchaser and was providing services to or acting on behalf of the purchaser. A suggestion was made that a consulting engineer should be given the authority to exercise independent functions only in exceptional cases. Another suggestion was that the nature of independent functions to be exercised by the consulting engineer should be limited, e.g. to functions of a technical nature.

15. A view was expressed that the discussion of the exercise of independent functions by the consulting engineer should be retained, as the authority to exercise such functions was sometimes, in practice, given to consulting engineers. It was suggested that the parties might in some cases consider it desirable to authorize the consulting engineer to exercise such functions since he would be knowledgeable about the construction and would be available to deal expeditiously with questions, problems or disputes concerning the construction. The view was expressed, however, that the giving of such authority to the consulting engineer should be presented only as an option which the parties might wish to consider in drafting a works contract, and not as a recommendation for inclusion in the contract.

16. In connection with the question of authorizing the consulting engineer to exercise independent functions, a view was expressed that a distinction should be made between the case where the consulting engineer was selected by the purchaser alone, and the case where the consulting engineer was selected by both parties. Where the consulting engineer was selected by the purchaser alone, views were expressed that the consulting engineer should not be authorized to exercise any independent functions, and that if he were authorized to do so, such functions should be limited. Another view was expressed that a consulting engineer who was selected by the purchaser alone should not have the authority to take decisions which were binding on the contractor. According to an additional view, however, there was no reason why the consulting engineer should not be able to take binding decisions if the parties had confidence in the consulting engineer and agreed to his taking such decisions even if the consulting engineer was engaged by the purchaser. Where the consulting engineer was selected by both parties, he might be authorized to exercise broader independent functions, including taking decisions binding on the parties. Suggestions were made that the consulting engineer should not be able to

exercise independent functions concerning matters in respect of which he had provided services or acted on behalf of the purchaser, and that in exercising independent functions the consulting engineer should be obligated to act impartially with respect to the purchaser and the contractor.

17. A suggestion was made that each party should appoint a consulting engineer at the time of entering into the contract, and that these consulting engineers should have authority to take decisions binding on the parties concerning matters of a technical nature. Another suggestion was that there might be one consulting engineer to render advice and technical expertise to the purchaser and to act on behalf of the purchaser, and another consulting engineer to exercise independent functions. A view was expressed, however, that it was unwise for more than one consulting engineer to be serving at the same time.

18. A further suggestion was made that the consulting engineer might be authorized to take decisions binding on the parties where the value involved in such decisions was less than a certain stipulated amount, and that decisions involving a value over that amount should be referred to mediation before an independent mediator, named in the contract, who was readily available to take such decisions. If mediation was unsuccessful, the matter would be referred to arbitration or judicial settlement. A suggestion was also made that a consulting engineer who was authorized to perform an act or take a decision independently should be obligated to perform such act or take such decision within a specified period of time.

19. With respect to the functions listed in paragraph 8, it was generally agreed that the secretariat should reconsider which functions were independent functions and which were performed on behalf of the purchaser. In addition, it was suggested that the secretariat should consider which of those functions should be transferred to the discussion in the chapter "Settlement of disputes". It was generally agreed that the consulting engineer should not be authorized to adapt the contract in a hardship situation if the parties were unable to agree on an adaptation.

20. With respect to the selection of the consulting engineer, it was noted by the secretariat that in many cases the identity of the consulting engineer designated by the purchaser would have been communicated to the contractor prior to the conclusion of the contract, and that the consulting engineer would be named in the contract; in such cases, the consulting engineer might be viewed as having been selected by both parties.

21. With respect to the replacement of the consulting engineer, it was generally agreed that the purchaser should be able to select the replacement without the participation of the contractor when the consulting engineer only rendered services to or acted on behalf of the purchaser. In respect of the case where the consulting engineer was to exercise independent functions, the view was expressed that if the purchaser

selected the original consulting engineer without the participation of the contractor, he should also be able to select the replacement consulting engineer without the participation of the contractor. In such a case, however, the purchaser should be obligated to notify the contractor of the replacement selected by the purchaser. On the other hand, if the original consulting engineer was selected by both the purchaser and the contractor, the replacement consulting engineer should be selected in a similar manner. A suggestion was made that, if the purchaser were permitted to select a replacement consulting engineer without the participation of the contractor, he should not be permitted to select a consulting engineer who was on his own staff. It was noted that international lending institutions might object to the participation of the contractor in the selection of a replacement consulting engineer when the replacement only provided services to or acted on behalf of the purchaser, but not when he exercised independent functions.

22. A view was expressed that if the contractor were permitted to object on "reasonable grounds" to a replacement consulting engineer proposed by the purchaser, the contractor's lack of knowledge of the proposed replacement consulting engineer should be regarded as reasonable grounds. A suggestion was made that the contract should provide that if the parties could not agree on a replacement consulting engineer, they might agree on a third party who would make the selection. It was generally agreed that the Guide should advise the parties to deal with the question of the extent to which a replacement consulting engineer should be bound by acts and decisions taken by the original consulting engineer.

23. With respect to the delegation of authority by the consulting engineer, a suggestion was made that the reference in paragraph 17 of the draft chapter to the ability of the consulting engineer to delegate his authority among his employees should be deleted. It was also suggested that the chapter should indicate that the delegation of authority by a consulting engineer was regulated by the rules of some national legal systems.

24. With respect to the information and access to be provided to the consulting engineer, it was generally agreed that the consulting engineer should have no greater rights than did the purchaser. A view was expressed that the works contract should give to the consulting engineer, in his own right, the authority to require a construction schedule from the contractor and to require the contractor to vary the schedule, to co-ordinate the work of all contractors involved in the construction, to inspect the plant during construction and, in a cost-reimbursable contract, to inspect the contractor's accounts. A further view was expressed that the consulting engineer should have such authority only in respect of his independent functions. The prevailing view, however, was that any such authority of the consulting engineer should be derived from authority possessed by the purchaser himself and should not be accorded to the consulting engineer in his own right. It was suggested that the role of the

consulting engineer with respect to the scheduling of construction work should be referred to in the section "Rendering advice and technical expertise to the purchaser".

Transfer of ownership of property¹⁸

25. The view was expressed that the distinction between the terms "plant" and "works" might not be clear and should be clarified. The question was raised whether the guide should deal with transfer of ownership of tools and construction machinery to be used for effecting construction. There was wide support for the view that this issue should not be dealt with in this chapter, but rather in another chapter, e.g. the chapter on security for performance, with appropriate cross-references.

26. It was suggested that the section "General remarks" might need some clarification. A view was expressed that the relationship between the transfer of ownership and the passing of risk might require some additional explanation, since under some legal systems the time of the transfer of ownership might be relevant for the passing of the risk of loss or damage if the parties did not agree upon a different approach in the contract.

27. It was agreed to amalgamate paragraphs 4 and 5 and to deal with the time of the transfer of ownership of equipment and materials in general terms without reference to the examples indicated in the present text. However, the need to avoid multiple transfers and re-transfers of property should be stressed. The heading of section C should be adapted to conform to the terminology to be used in the final version of the Guide.

Applicable law¹⁹

28. It was noted that the chapter assumed that the parties would choose the rules of a legal system of a single State to govern their contract. Other approaches, however, were possible, e.g. the contract could be governed by legal principles common to the legal systems of the two countries to which the parties belonged, or by general principles of law commonly accepted in international trade. The parties could also provide that different contractual obligations were to be governed by different legal systems. It was observed that, in presenting the latter approaches, the chapter should also indicate possible difficulties inherent in these approaches. For instance, it might be difficult to identify the legal principles referred to. In addition, certain legal systems might not recognize the validity of such a choice, and consequently courts would determine the law governing the contract on the basis of the rules of private international law. There was a proposal to change the title of the chapter to "Choice of law". There was also a proposal that the French title be changed to "*Loi applicable*".

¹⁸A/CN.9/WG.V/WP.15/Add.4.

¹⁹A/CN.9/WG.V/WP.15/Add.5.

29. There was wide agreement that most legal systems did not specifically deal with works contracts of a complex character. The parties should therefore be advised to deal with problems which might arise under works contracts, to the extent possible, by including appropriate terms in their contract.

30. The view was expressed that the Guide should bring to the attention of the parties the question of the time factor in relation to the choice of the applicable law, i.e. whether the applicable law was the law as it prevailed at the time of the conclusion of the contract, excluding subsequent modifications to this law, or was the law which prevailed at the time of the conclusion of the contract subject to future modifications. The Guide might also bring to the attention of the parties the possibility of making rules of law applicable by incorporating them in the contract in the form of contract terms. In addition, the parties might be advised that making the same law applicable to the works contract as well as to contracts between the contractor and sub-contractors might facilitate the co-ordination of such contracts.

31. It was observed that the description in the chapter of mandatory laws which might limit the autonomy of the parties in choosing the applicable law was not sufficiently comprehensive. For example, mandatory laws regulating unfair contract conditions might limit party autonomy. Moreover, parties could not derogate from certain rules of private international law determining which law was applicable to resolve certain issues relating to immovable property. It was also noted that a court might derogate from the application of some provisions of the law chosen by the parties by applying legal rules having the character of *ordre public*.

32. Differing views were expressed on the suggestion contained in the chapter that, in making a choice of law, the parties should specifically refer to the "substantive" rules of a legal system. It was noted that the term "substantive" was capable of different meanings: it could be used to emphasize a contrast with rules of private international law rules, or to emphasize a contrast with procedural rules. Under one view, the use of this term when making a choice of law was unnecessary, as it was self-evident that the choice of a legal system did not include a choice of rules of private international law or procedural rules. Under another view, the use of this term was desirable to indicate that the parties at least excluded the application of rules of private international law. It was noted in this connection that, while the choice of a procedural law to govern the procedure for the settlement of disputes would be ineffective when the disputes were adjudicated in a court (since a court would always apply its own procedural law), such a choice may be effective when disputes were settled by arbitration.

33. The Working Group considered the reference in the chapter to the possible application to works contracts of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). It was observed that the provisions of the Convention defining when the Convention was appli-

cable to contracts for the supply of goods to be manufactured or produced should be described in greater detail. Under one view, these provisions had the result that the Convention applied very infrequently to works contracts. Under another view, however, certain legal systems classified works contracts as sales contracts. Accordingly, a choice by the parties of such a legal system to govern a works contract might have the result that the Convention became applicable. It was also noted that parties might sometimes wish expressly to choose the Convention to regulate their contract. There was support for the view that any discussion of the possible application of the Convention to works contracts should be in the body of the chapter, and not in a footnote.

34. The view was expressed that, instead of making a direct choice of the law which was to govern the contract, the parties might choose the court which was to adjudicate on disputes arising out of the contract, or choose an arbitral institution according to the arbitration rules of which such disputes were to be arbitrated. The applicable law could then be chosen by such court, or by the arbitrators. A further suggestion was that issues directly relating to the choice of jurisdiction, e.g. when such a choice might be invalid, would appropriately be discussed in the chapter on the settlement of disputes, and not in this chapter.

35. The Working Group discussed the manner in which a choice-of-law clause might be formulated. There was considerable support for the view that it was necessary for a choice-of-law clause only to identify the legal system which was to govern the contract. There was some support for the view that, in addition to such an identification, the choice-of-law clause should indicate that the chosen law was to govern formation and validity of the contract and possibly also the consequences of invalidity. In opposition to this view, it was observed that it was logically impossible to choose a law to govern the issues of formation and validity, since the choice would only be effective if the contract had been formed and was valid. There was less support for the view that the choice-of-law clause should enumerate in detail the issues to be regulated by the chosen law. It was agreed that the illustrative choice-of-law provision in the chapter should have three variants illustrating these different approaches. It was also agreed that the phrase "mandatory legal rules of a public nature" needed clarification.

36. The Working Group considered the discussion in the draft chapter relating to the party who was to bear the risk of a change in the mandatory rules concerning technical aspects of the works or its construction, or of the creation of new rules, after the conclusion of the contract (paragraph 17). It was observed that the significance of this discussion would be more apparent if the recommendation which immediately preceded this discussion regarding the obligation to be imposed on the contractor (i.e. the obligation to construct the works in accordance with applicable technical legal rules: paragraph 16) was modified. The Guide should recommend that the contractor be obligated to construct

the works in accordance with applicable technical legal rules prevailing at the time of the conclusion of the contract.

37. It was suggested that the discussion as to which party should be obligated to obtain approvals, authorizations or licences necessary for the performance of the contract should be placed in a different chapter where such discussion would be more appropriate. It was further suggested that the section entitled "General remarks" needed clarification. This section should elucidate more clearly the problems which were addressed in the succeeding sections of the chapter. The view was also expressed that the chapter should include more illustrative provisions. Several suggestions were made for improving the drafting of the chapter.

Price²⁰

38. It was suggested that the title of the chapter should also refer to "payment conditions". It was suggested to change the title of the chapter to "Costs" instead of "Price". This proposal was, however, not adopted. The view was expressed that the section "General remarks" should indicate that international lending institutions might require that the issues discussed in this chapter be settled in particular ways. A suggestion was made that the issue of adjustment of the price should be discussed in the substantive chapters devoted to the various circumstances which might give rise to such adjustment, e.g. in the chapters "Variation clauses" and "Hardship clauses". The secretariat was asked to consider whether additional illustrative provisions might be included in this chapter.

39. A view was expressed that the Guide should not refer to the case where no pricing method was provided in the contract, as this case did not occur in practice. It was stressed that the unit-price method was not interchangeable with the other two pricing methods mentioned in paragraph 2. It was suggested that paragraph 5 should be redrafted so as to make it clear what consequences would arise from a violation of the legal rules mentioned in this paragraph.

40. Different views were expressed regarding the terminology to be used in the section on adjustment and revision of the price. There was general agreement that the distinction between adjustment and revision should be made clearer. A view was expressed that a lump-sum price should be subject to revision only in accordance with the applicable law or a revision clause included in the contract. It was suggested that the Guide should indicate that some legal systems provided for an adjustment of the price even if there was no contractual provision on this issue. According to an additional view, the price should be stable and adjustment or revision of the price should be exceptional. In this connection it was suggested that the phrase "subject to a price adjustment or price revision clause included in the contract" should be deleted from the second sentence of paragraph 8.

41. It was suggested that the influence of the method of pricing on the need for adjustment and revision of price should be stressed. It was noted that where the cost-reimbursable method of pricing was used, the ceiling or target costs specified in the contract might need to be adjusted or revised in certain circumstances (e.g. if the scope of construction was varied). A view was expressed that some of the situations discussed in the section on adjustment of price were not questions of adjustment of price, but rather of the liability of a party. With respect to changes in local regulations, a suggestion was made that the Guide should only describe the problems involved, and should leave the choice of a settlement of the problems to the parties.

42. It was suggested that it should be mentioned in paragraph 9 that the contractor might protect himself against the risk mentioned in that paragraph by including an adjustment or revision clause in the contract. The view was expressed that paragraph 9 should be redrafted so as simply to refer to the risks associated with various pricing methods. A suggestion was made that the word "quality" might be deleted from the last sentence of this paragraph. It was observed that it might be useful to clarify the distinction between a lump-sum price, which might be subject to a revision in certain situations, and a fixed price. It was observed that in some cases the cost-reimbursable method of pricing was used even in turnkey contracts, and it was suggested that the first sentence of paragraph 15 should be redrafted accordingly.

43. With respect to the cost-reimbursable method of pricing, it was suggested that the distinction between reimbursable costs and the fee should be clarified, and that the guide should indicate which costs incurred by the contractor might be covered by the fee and therefore should not be considered to be reimbursable costs. An observation was made that even in cases where a fixed fee was agreed, the contractor usually had an interest to complete the construction as soon as possible.

44. It was suggested that the Guide should describe the various types of cost-reimbursable contracts used in practice (e.g. cost-plus-percentage and cost-plus-fixed-fee). The view was expressed that the Guide should not imply that the pricing method was the only factor relevant to the incentive of the contractor to complete the construction in time. It was suggested that the Guide should recommend that the cost-reimbursable method of pricing should not be used if the estimated costs of construction were not known to the purchaser at the time of the conclusion of the contract; however, it was noted that such estimates would usually be known to the purchaser. It was pointed out that the purchaser's participation in the selection of sub-contractors of the contractor was relevant as a method of controlling reimbursable costs (i.e. the costs of the sub-contractor's services) only in the case of sub-contractors who were not specified in the contract.

45. It was observed that international lending institutions did not in all cases oppose the cost-reimbursable

²⁰ A/CN.9/WG.V/WP.15/Add.1.

method of pricing. A suggestion was made to delete paragraph 13. There was considerable support for the view that, when the cost-reimbursable method was used, the purchaser should have a right to audit the contractor's records in order to verify the costs incurred by the contractor. A view was expressed that termination of the contract in cases when actual costs exceeded the target cost was not desirable, and that the reference to that possibility should either be deleted or should be limited to cases where an agreed ceiling was exceeded. A suggestion was made that this issue should be dealt with in the chapter "Termination".

46. It was suggested that the Guide should contain more typical examples of unit pricing. A view was expressed that the Guide should refer to the possibility of adjusting the price for a construction unit when the quantity of units actually used in the construction varied by more than a specified percentage from the quantity estimated at the time of the conclusion of the contract.

47. A view was expressed that a bonus payment for early completion of construction should not be used in connection with the cost-reimbursable method of pricing, since this might induce the contractor to incur higher costs (e.g. by hiring additional labour) in order to obtain the bonus. It was suggested that the last sentence in paragraph 29 should be deleted. According to an additional view, a bonus payment should not depend upon the continuous operation of the works; rather, payment of a bonus should depend upon whether the purchaser received an anticipated profit from an earlier operation of the works. One view suggested that continuous operation of the works should not be required, and that the bonus might be payable upon the commencement of the operation of the the works. Another view was expressed that a bonus payment should not be provided for in the contract, but should be agreed upon only after conclusion of the contract if the earlier completion of construction was of benefit to the purchaser.

48. It was suggested that the section on the currency of the price should stress the distinction between the currency in which the price was determined (currency of account) and the currency in which the price was to be paid. A further suggestion was made that the section should refer to problems associated with fluctuations in the purchasing power of the price currency, in addition to fluctuations in exchange rates.

49. A suggestion was made that paragraph 31 should specifically refer to foreign exchange regulations in force in the countries of both parties. A view was expressed that the currency of the purchaser's country should be used in the contract in most cases, and that if another currency were used a relevant foreign exchange rate should be included in the contract. It was suggested that paragraph 33 should clarify the advantages and disadvantages for the purchaser of the approaches mentioned therein with respect to the currency in which costs should be reimbursed. It was pointed out that paragraphs 32 and 36 might need to be harmonized.

50. It was suggested that the Guide should refer to the need to change an index clause in the event of substantial variations in the scope of construction or of a substantial change in economic factors relevant to the contract. The desirability of simplicity of the index clause was stressed. A view was expressed that paragraph 50 should be deleted or that it should only indicate that the index clause normally applied to each payment when it was made. It was noted that under the laws of some countries the use of index clauses was restricted or was not allowed at all.

51. It was suggested that the approach described in the last sentence of paragraph 53 should be limited to cases where the contractor was responsible for the delay. Another view was that this sentence should be deleted. It was suggested that the index clause should apply only in cases where its application would result in change exceeding a certain percentage of the price.

52. With respect to footnote 1, a view was expressed that it might be advisable to draw the attention of the parties to limitations which might exist in national law concerning the power of a court to adjust the weightings used in an index clause. It was suggested that it would be helpful to add some explanatory notes to the index clause formula contained in the appendix.

53. A view was expressed that in the case of a delay by the purchaser in making a payment to the contractor, a currency clause might give the contractor a choice between the exchange rate prevailing at the time of maturity of the obligation to pay or that prevailing at the time of actual payment. It was suggested that the section dealing with the unit of account clause should also refer to the European Currency Unit (ECU) as a unit of account.

54. A suggestion was made to delete the percentages in paragraph 63, as well as the part of the last sentence of that paragraph dealing with applicable foreign exchange restrictions. Views were expressed that the first sentence of paragraph 63 might be superfluous, and that the second sentence of paragraph 64 should be deleted.

55. It was suggested that the section dealing with payment during construction should mention payment conditions which might be used in connection with the cost-reimbursable method of pricing, since these might differ from those used in connection with the lump-sum pricing method. With respect to payment by the purchaser for equipment or materials supplied by the contractor, it was suggested that payment might fall due prior to delivery of such items to the purchaser upon presentation by the contractor of documents proving that insurance of the equipment or materials had been taken out, in addition to the presentation of other documents, such as documents proving that the equipment or materials had been handed over to the first carrier for delivery to the purchaser.

56. With respect to credit granted by the contractor, one view was that such credits are used in practice only

exceptionally. According to another view, however, it was not uncommon for the government of the contractor's country to guarantee or otherwise back credit granted by the contractor to the purchaser. Various suggestions were made for improving the drafting of the chapter.

Transfer of technology²¹

57. There was general agreement that the issues dealt with in this chapter were of great importance to the purchaser. It was also agreed that the chapter dealt with these issues in a balanced manner. It was noted that some of the terms used in the chapter might need further explanation. Thus the term "mandatory", often used to qualify the term "legislation regulating technology transfer", might need clarification, as such mandatory regulation might take place in different ways. It should also be clarified that know-how might be confidential and known only to the contractor, or might not be confidential and known to others as well. Moreover, in some countries the term "licensing" was used not only in relation to patents, but also to describe the communication of know-how.

58. The view was expressed that a more detailed account might be given of national legislation which regulated technology transfer. The terms of the contract might be effected by such legislation prevailing not only in the country of each party, but also in other countries. In this connection, it was observed that some legislation provided for compulsory licensing of technology in certain circumstances. In some countries, legislation restricted the rights of contractors who were parties to transfer of technology contracts.

59. It was suggested that the different kinds of technology, and the ways in which such technology might be transferred either individually or in combination, might be described at the commencement of the chapter. It was suggested that in this chapter reference should be made to follow-up improvements to the transferred technology. Furthermore, the possible reasons (e.g. cost considerations) for choosing different contractual arrangements for the transfer of technology might be indicated. It was noted that the acquisition of a knowledge of the functioning of the works was not the most significant way in which technology was transferred. There was support for the view that the description of industrial property, and in particular the system of patents, needed further explanation. Reference should be made to the international conventions which regulated industrial property. It should also be indicated that patents had legal effect within defined territories.

60. With regard to the description of the technology, it was observed that under certain contracting approaches no separate description of the technology to be utilized would be needed, as the description of the scope and quality of the works would include a description of the technology to be utilized. With regard to conditions which might be inserted in the contract restricting the

purchaser in the use of the technology transferred, it was suggested that the reference to the ongoing discussion of such conditions at sessions of the United Nations Conference on an International Code of Conduct on the Transfer of Technology should be referred to in the section entitled "General remarks". It was observed that it was difficult to predict the impact of a possible Code of Conduct on the drafting of works contracts, since the extent to which the Code would bind parties, and the formulation of the Code provisions dealing with the restrictions in question, had not been finally settled. The view was expressed that the Guide should not incorporate the provisions of the Code of Conduct, although reference to the Code might be made. The Working Group decided to defer its decision on the reference to the Code of Conduct to a later date. It was agreed that the drafting of provisions illustrating such restrictive provisions should not be undertaken. However, the restrictive provisions which were relevant to, and might be inserted in, works contracts might be briefly identified and discussed. It was noted that it was inappropriate for a guide to seek to lay down normative standards for such restrictive provisions, and that in any event party autonomy in inserting such restrictive provisions was often limited by national legislation.

61. It was noted that the appropriate form of a guarantee in regard to technology would depend on the contracting approach adopted. If, for example, the turnkey approach was adopted, no separate guarantee concerning the technology would be necessary, as the general guarantee concerning the quality and performance of the works would also cover the technology.

62. It was observed that the Guide should suggest that the contractor be required to guarantee that he was the owner of the technology which he was transferring, or that he be required to undertake that he would obtain the right to transfer the technology. There was support for the view that the last sentence of paragraph 12 should be deleted, or at least considerably modified, both because its contents did not assist the parties in drafting their contract, and because the rule stated therein that the contractor be permitted to avoid liability was debatable. The view was expressed that the situation dealt with in the penultimate sentence of paragraph 19 (i.e. where the purchaser terminated the contract because of a failure of performance by the contractor) should also be examined from the standpoint of its impact on guarantees given by the contractor. It was suggested that, even when in such situations the contract was completed by another contractor, the original contractor should remain bound by the guarantees given by him in regard to the technology supplied by him. It was also observed that the Guide should indicate that guarantees given by the contractor would be ineffective if the works were operated by the purchaser's personnel in an improper manner.

63. In regard to price, it was suggested that the description of the various methods of pricing technology might be further elaborated. In this connection

²¹A/CN.9/WG.V/WP.15/Add.3.

it was noted that mention might be made of the method whereby the price was paid in the form of the delivery of the products of the works. Under another view, however, such payment methods properly belonged to the domain of countertrade, and did not need special mention in the present context; such methods might perhaps be mentioned in the chapter "Price".

64. The view was also expressed that the appropriate payment methods to be adopted might depend on the length of the period of time for which the payments were to be made (e.g. if royalties were to be paid over a long period, the amount of each instalment might be less than if royalties were to be paid over a short period). It was also observed that the transfer of confidential know-how was usually paid for by a down payment. There was wide support for the view that the pricing of technology should be dealt with in the chapter "Price". It was agreed that the discussion of the price payable for training might be retained in this chapter, but that a cross-reference should be made in the chapter "Price" to the discussion in this chapter.

65. With regard to the infringement of the rights of a third party through the use of the technology transferred, it was noted that in practice transferors of technology only undertook that the use of the technology would not infringe the rights of third parties in specified territories. Transferors would usually state that they were unaware if the rights of third parties would be infringed in other territories. It was also observed that the Guide should refer to the possibility that the rights of third parties might be infringed, not merely through the use of the industrial processes transferred, but through the distribution of the products produced in the completed works.

66. It was noted that no extensive discussion of the remedies for the infringement of the rights of a third party was necessary, as such remedies were laid down by the applicable law, and might vary among different legal systems. The chapter might usefully deal with the allocation of the rights which parties might have in the event of infringement. In this connection it was noted that, under many legal systems, guarantees against such infringement were implied by the law and need not be regulated by contract provisions.

67. The question was considered whether all the cases where the rights of a third party might be infringed in the course of the implementation of a works contract should be discussed in the Guide at a single location. It was observed that such a treatment would be logical and could be comprehensive. The view was expressed, however, that a treatment of the issue in the various sections of the Guide where the factual situations giving rise to particular infringements were described might be of greater assistance to the reader of the Guide.

68. The suggestion in the Guide that when legal proceedings were brought against a party for infringement, the other party should be obligated to assist the former party in defending these proceedings, was discussed. It was observed that the nature of the

obligation to assist needed further clarification, e.g. the extent of the assistance to be given should be specified. It was also noted that under certain legal systems procedures existed under which the party sued could compel the other party to participate in the suit.

69. With regard to confidentiality, there was agreement with the view expressed in the chapter (paragraph 18) that the contractor might wish to obligate the purchaser to maintain confidentiality as to know-how disclosed by the contractor at two stages: at the stage of negotiations and, if the negotiations led to the conclusion of a works contract, at the stage when a works contract was concluded. It was noted that under some legal systems this might require the conclusion of an independent contract as to confidentiality before negotiations commenced, and subsequently the inclusion in the works contract of terms requiring confidentiality. Under other legal systems, however, no contract might be required prior to negotiations, as concepts such as good faith contained in such legal systems imposed a duty of confidentiality. It was also observed that, where a contract as to confidentiality was concluded prior to negotiations, such a contract should provide that the obligations as to confidentiality were to continue after the conclusion of the negotiations even if no works contract was later concluded as a result of the negotiations.

70. There was support for the view that a contract which contained obligations of confidentiality as to know-how might also provide that such obligations should cease, and that royalties for the know-how might cease to be payable, if the know-how reached the public domain. The Working Group considered the case where a contract was terminated by the purchaser because of a failure of performance by the contractor, and the purchaser then found it necessary to disclose to another contractor such of the know-how as was necessary for completion of construction by the other contractor. It was observed that the works contract should in such cases obligate the purchaser to require from the other contractor an undertaking that the latter would not disclose the know-how he acquires to others. It was also suggested that such disclosure by the purchaser (both in the circumstances discussed, and when the contractor was prevented by an exempting impediment from completing the construction) should only be permitted in so far as the contractor was in a position to give the purchaser permission to disclose the know-how to the other contractor.

71. With regard to the supply of documentation, it was noted that the list of the types of documents which might be supplied could be amplified (e.g. to include operating personnel and desirable spare parts). It was also noted that it was not always necessary for the supply of all documentation to be completed by the time fixed in the contract for the completion of construction. For example, under a *produit en main* contract, the documentation might be provided after completion.

72. With regard to the training of personnel, it was observed that the contractor might not have the

capability to effect the training. It might be preferable for such training to be arranged by the consulting engineer, or to be effected by an institution specialized in training. It was also observed that domestic legislation which often existed regulating working conditions might also relate to the training of personnel and that account should be taken of that legislation. Such legislation was often designed to protect the rights of workers, and might restrict the rights of employers to determine the conditions of training.

73. It was observed that where the feasibility of training a particular trainee was in doubt, the contractor or other trainer should be entitled to require the purchaser to provide a replacement trainee. In such cases, the contractor or other trainer should be obligated to inform the purchaser of the need for a replacement as soon as he became aware of such a need. It was noted, however, that the legislation referred to in the preceding paragraph might restrict the freedom of the contractor and purchaser with regard to the replacement of a trainee.

74. It was noted that the chapter did not address the question of possible damages which might be caused by trainees to the works at which they were being trained. It was suggested that the Guide should advise the parties to settle in the contract the question as to which party was to bear the loss resulting from such damage. The view was also expressed that the contract should also settle the question as to which party was to bear the responsibility if harm was suffered by trainees in the course of the training.

75. The view was expressed that, where the purchaser required training of his personnel, the contractor would always require to be remunerated for the cost of such training. Such cost might be included in the overall price charged for the construction, or might be specified separately.

76. It was noted that the subject of training embraced certain practical matters which the purchaser would have to address. Thus it was possible that personnel after receiving their training might leave the service of the purchaser. The purchaser might also find it advisable to make an independent assessment of his personnel requirements, rather than to rely exclusively on the contractor's judgement, since the purchaser was better acquainted with the capabilities of local personnel. Furthermore, the purchaser would need to obtain visas or travel authorizations for trainees who were to be sent abroad for training, and accordingly the contract might obligate the contractor to assist the purchaser in obtaining such visas or travel authorizations. The view was also expressed that, due to various reasons, the construction might sometimes be interrupted or delayed. It was noted that the contract should provide for the training programme to be adapted if interruptions or delay occurred.

77. There was wide agreement that the Guide should seek to avoid formulating recommendations in mandatory terms, but rather should present recommendations

in the form of options which the parties might consider in drafting their contract. Several suggestions were made for improving the drafting of the chapter.

Construction on site²²

78. It was generally agreed that the secretariat should reconsider the use of the terms "construction" and "erection", and should ensure that these terms were used consistently throughout the chapter. It was also generally agreed that the secretariat should reconsider the usage of the word "should", with a view towards achieving a neutral presentation of the approaches to the issues discussed in the chapter. A view was expressed that the issue of timing (e.g. time for completion, time schedule) should receive greater emphasis, perhaps by referring to this issue in the title of the chapter. An additional view was expressed that the section "General remarks" should be expanded so as to provide a fuller introduction to the issues dealt with in the chapter. Reference was made to the possibility that a contractor might be engaged to erect equipment supplied by other contractors.

79. Views were expressed that the Guide should recommend that the parties deal with the question of which party was to pay the costs of facilities needed for the purposes of construction by the contractor's personnel, and that the contract stipulate the standard of the facilities to be provided. A view was expressed that the Guide should also advise the parties to consider whether the contractor should be obligated to provide certain facilities for the purchaser's personnel. With reference to paragraph 6, a suggestion was made that the Guide should advise the parties to consider whether and under what terms the purchaser would have the right to acquire the workshop after the completion of construction and that, accordingly, the last sentence of this paragraph should be deleted. It was noted that under rules of national law the contractor would usually be responsible for the working conditions of his own personnel on site, and it was suggested that the Guide advise the parties to take such rules into consideration in dealing with the question of accommodation, utilities and other facilities on site.

80. A suggestion was made that, in connection with the discussion of machinery and tools for effecting construction, reference should also be made to the possibility of leasing of such machinery and tools. It was noted that licences and authorizations may be needed for the import of machinery and tools to the country of the site, whether or not they were to be re-exported. It was suggested that the types of transport intended to be covered by paragraph 9 should be clarified.

81. A view was expressed that the contract should always set forth a time for completion of construction and that the second sentence of paragraph 11 should accordingly be deleted. A suggestion was made that if

²²A/CN.9/WG.V/WP.15/Add.6.

the contract set forth a fixed date for completion, it should also establish when construction should commence.

82. A view was expressed that the list in paragraph 12 of dates to be used for determining the time when construction was to commence should not be exhaustive. A suggestion was made to add to this list the date when the site was handed over to the contractor; it was noted, however, that this might not be the relevant date in all cases, as in the case where the contractor was to commence the manufacture of equipment on his own premises prior to the handing over of the site. A further suggestion was made that in addition to the date of receipt by the contractor of an advance payment, reference should also be made to the date of delivery by the purchaser to the contractor of a guarantee that such an advance payment would be made. A suggestion was made that item (b) of paragraph 12 should be clarified so that the last element (i.e. "that construction should begin") would be set forth as an additional date for commencement and not as an alternative.

83. A suggestion was made that paragraph 14 should be redrafted so as to reduce the emphasis on the purchaser's possible interest in early completion of construction. An additional suggestion was that references should be made in this section to the chapters "Failure to perform" and "Liquidated damages and penalty clauses".

84. With respect to the time schedule for construction, a view was expressed that the contract should contain a basic time schedule for the performance of major tasks and should provide for a detailed time schedule to be prepared by the contractor after the contract had been concluded. It was also suggested that the Guide should refer to the possibility of using computerized time schedules.

85. A view was expressed that it was not appropriate in a turnkey contract to provide for sanctions if a milestone date in the time schedule was not met by the contractor, since what was important was whether the entire construction was completed on time. It was generally agreed, however, that the Guide should merely state that milestones might be given different degrees of importance in different types of contracts, and recommend that the parties should agree upon the consequences of a failure by the contractor to meet such milestones. Another view was that the right of the purchaser to order the contractor to speed up construction, referred to in paragraph 16, was of no value unless the contract also provided for the consequences of a failure by the contractor to do so.

86. Different views were expressed concerning the possibility of the contractor's terminating the contract if the purchaser did not require the commencement of construction within a specified period of time. According to one view, this possibility was too harsh and should be deleted from paragraph 16. According to another view, this possibility should be retained, as there had to be some limit to the period during which the contractor's obligation to begin construction would subsist.

87. It was observed that the section on extension of time for completion of construction should be redrafted and compressed. It was generally agreed that the Guide should recommend that the parties consider whether the question of extension of time was adequately dealt with by the applicable law, or whether the contract should provide for extension in certain circumstances. It was also generally agreed that the chapter should merely refer to other chapters dealing in substance with circumstances which might justify an extension, and that such circumstances should not be dealt with in this chapter. It was suggested that the guide should clarify by whom the duration of an extension would be determined if the parties could not agree upon a "reasonable" extension. It was also suggested that the contractor should not be entitled to stop construction either during negotiations or during dispute settlement proceedings concerning such an extension.

88. With respect to construction to be performed under the contractor's supervision, it was suggested that a distinction should be made between an obligation of the contractor to supervise and inspect the construction and an obligation merely to give advice to the personnel effecting such construction. It was suggested that the contractor should be obligated to keep a record of the performance of his obligations as to inspection. It was generally agreed that the last portion of paragraph 24 should be redrafted so as to make it clear that the contractor might not be liable for defects caused by a failure of persons engaged by the purchaser to follow the contractor's instructions, but that the contractor might be obligated to inspect work performed by such persons and inform the purchaser of any such defects and might be made liable for a failure to fulfil those obligations.

89. A view was expressed that the contract should refer to the risks involved in performing supervisory functions and that the damages payable by the contractor for a failure to supervise should be limited. A view was also expressed that the purchaser should be liable to compensate the contractor for losses arising from a delay in the completion of construction resulting from a failure to perform by persons engaged by the purchaser.

90. The view was expressed that the section "Access to site and plant" should be compressed and should indicate in general terms that provision should be made in the contract for access by various persons to the site.

91. It was noted that working conditions were often governed by rules of law in the country of the site. It was generally agreed that the Guide should merely recommend that the contract provide for the allocation of responsibilities for working conditions and for the content of such responsibilities, taking into account relevant rules of national law.

92. It was generally agreed that the opening chapter of the Guide should stress that the full co-operation of the parties was essential for the smooth progress and successful completion of construction and that this co-operation should extend through every phase of the

contract. It was suggested that the secretariat should reconsider the appropriate location in the Guide for the discussion of liaison agents.

93. It was suggested that provision should be made in the contract for payment by the purchaser for items procured by the contractor on behalf of the purchaser separately from provisions dealing with other elements of the price to be paid by the purchaser.

94. Suggestions were made that the contractor should be obligated to leave the site in a clean and workman-like condition and that the words "after completion" should be deleted from the heading of section J of the chapter. Various other suggestions were made for improving the drafting of the chapter.

Revised draft outline of the structure²³

95. A view was expressed that definitions of terms used in the Guide should be set forth in a separate chapter containing a glossary of terms in accordance with an earlier decision tentatively adopted by the Working Group. Under another view, however, such an approach might not be adequate because of difficulties inherent in defining various terms in a concise manner, and it would be preferable that terms be defined or explained in the chapters in which the terms were used. It was agreed that the preparation of an analytical index in alphabetical order would enable the reader to find without difficulty a definition or explanation of terms used in the Guide in the context of a particular inquiry.

96. A view was expressed that the quality guarantee should not be dealt with in the chapter "Description of works". This suggestion was not adopted by the Working Group.

97. It was suggested that the section on the semi-turnkey contract approach in chapter II, "Choice of contracting approach", should be deleted. It was decided that the decision on such deletion should depend upon the decision of the Working Group relating to this section during its discussion of chapter II.

98. It was suggested to change the locations in the structure of the chapter "Consulting Engineer" and the chapter "Sub-contracting"; however, this suggestion was not adopted by the Working Group. It was agreed to place the chapter "Transfer of technology" after the chapter "Description of works" and to place the chapter "Price" after the chapter "Transfer of technology". It was noted that the chapter "Delay, defects and other failures to perform", should include some general remarks explaining the relationship among various remedies and forms of compensation for failure to perform. It was observed that the chapter "Liquidated damages and penalty clauses" might be placed before the chapter "Damages".

99. Views were exchanged on the question of the appropriate place to deal with the issues in respect of the applicable law. It was agreed that some problems connected with drafting works contracts in the light of the applicable law might be discussed in the introduction to the Guide and in various other chapters where such discussion might be instructive. It was noted that some revision of terminology might be needed in the Arabic version of the outline of the structure of the Guide.

Choice of contracting approach²⁴

100. There was wide agreement that the chapter in its present form was in general acceptable, but that certain modifications to its structure, and in certain matters of detail, would result in greater clarity. There was also wide agreement that the chapter should seek to avoid giving any impression that the contractual arrangements which might be entered into for the construction of industrial works could be divided into well-settled categories which were clearly distinct. While the main characteristics of certain contractual approaches (e.g. the turnkey contract approach, the product-in-hand contract approach and the separate contracts approach) were generally recognized, and should be described, it should be stressed that a range of gradations was possible in regard to contractual arrangements. Such gradations could not be easily categorized. It was observed, however, that this range of arrangements should also be reflected in the chapter, since it would be useful in particular for developing countries to be aware of such possible arrangements.

101. From the standpoint of the structure of the chapter, it was noted that a basic distinction might be drawn in the chapter between contractual arrangements, under which only one party was engaged to effect the construction, and contractual arrangements involving the engagement of more than one party. The chapter could then refer to the possible advantages and disadvantages of the two forms of arrangement and might thereby avoid some repetition which existed under the present treatment of different contract approaches. In dealing with the first type of arrangement, the chapter could cover the turnkey and product-in-hand contract approaches, while in dealing with the second type of arrangement the chapter could cover the approach under which the construction was divided among a large number of contractors (separate contracts approach).

102. In regard to the separate contracts approach, it was observed that it would be useful to indicate the nature of some of the separate contracts which were frequently entered into (e.g. for civil, mechanical or electrical engineering) and give some indication of which kinds of contracts would be required for different kinds of works. It was also observed that the technique sometimes referred to as "fast-track construction" should be explained. An additional view was expressed

²³A/CN.9/WG.V/WP.15/Add.7.

²⁴A/CN.9/WG.V/WP.15/Add.8.

that the existence of contractual arrangements involving supervision by a consulting engineer or project manager should be emphasized.

103. It was noted that the chapter might deal with the frequent case where the purchaser entered into a contract with a consortium of contractors, and also with the case where the construction took the form of a joint venture between the purchaser and the contractor. It was agreed that it would be sufficient if such arrangements, and the special issues arising in such arrangements, were dealt with in chapter I, "Identifying project and selection of parties", with appropriate cross-references in the two chapters.

104. With regard to the section "General remarks", it was agreed that the account given in that section should be amended to conform to the approach to be adopted for the chapter as a whole. It was observed that the discussion in paragraph 1 needed simplification and clarification. For instance, the reference to contracts of limited scope might be supplemented by a more specific discussion of such kinds of contracts (e.g. contracts for mechanical or electrical engineering). Cross-references might also be included to later chapters of the Guide where the issues dealt with in such contracts of limited scope were dealt with (e.g. the chapters on supply of equipment and materials and the transfer of technology), and the elaborate account of the various possible combinations of contracts of limited scope and works contracts might be unnecessary. It was noted that the statement in paragraph 2 as to the extent to which the purchaser participated in the construction might not always be true, as some of the obligations described as being undertaken by the purchaser at a minimum might, in some cases, be undertaken by the contractor. Accordingly, the guide might only advise the parties to determine the obligations which they might wish the purchaser to undertake.

105. It was observed that the view expressed in paragraph 3, that institutions financing construction might require certain approaches to contracting, might be deleted. With regard to the impact of tax legislation on contracting approaches, it was noted that a statement that such legislation might influence the contracting approach was sufficient, as tax legislation differed considerably in various countries and it would be impossible to give a full account of the different ways in which such legislation might influence the contracting approach. It was also suggested that the description of each contracting approach should include an account of the factors which might influence the parties in adopting the approach (e.g. the purchaser possessing or not possessing technological or managerial capabilities, or the need to adopt a particular pricing method).

106. With regard to the turnkey contract approach, it was noted that the paragraphs dealing with this approach would be subsumed under a section dealing with cases where only one party was engaged to effect the construction. The section would then give a clear description of the main characteristics of the turnkey

contract approach, while avoiding a definition. It was observed that some elements indicated as characteristic of the turnkey contract approach (e.g. that the contractor would be obligated to complete construction by a specified date) would also apply to other types of contracts, and it was suggested that such elements should not be used in the description. It was observed, however, that such elements might have to be included for the sake of completeness of the description.

107. In regard to the factors which might influence the adoption of the turnkey contract approach by purchasers in developing countries, it was noted that the relevant factor might not be the level of industrialization in the country in general, but the degree of technological capacity in the specific field relating to the works to be constructed. The view was also expressed that the Guide should reflect that the turnkey contract approach was not the only method of dealing with the problem of the lack of technological capacity faced by developing countries (e.g. a comprehensive contract approach might also be used).

108. There was agreement that the chapter should deal with the possible advantages and disadvantages of the turnkey contract approach. However, the description of such advantages and disadvantages should not be categorical, and the Guide might preferably focus on how possible disadvantages might be mitigated. It was observed that paragraph 8 did not clarify that the benefit of competition in respect of the design for the works resulted from the use of tendering procedures and not from the turnkey contract approach itself. The difficulties of comparing different turnkey offers (paragraph 9) also arose when tendering procedures were used. A suggestion was made that paragraphs 8 and 9 should therefore be deleted, as the issues dealt with in these paragraphs would be covered in the chapter dealing with the procedure for concluding the contract. The view was expressed that the last sentence of paragraph 10 should be deleted, as the idea expressed therein did not accord with practice. However, there was also support for retaining the idea, but to give it lesser emphasis.

109. With regard to the comprehensive contract approach, it was observed that the term "comprehensive contract" was not often used in practice or was used in a different sense; it might suffice for the chapter to describe the approach without using this term. It was also observed that the term "co-ordinate" (paragraph 13) was used in other chapters of the Guide where the activities of several persons were involved and that this usage should be consistently adopted. Furthermore, the use of the term "professional" to refer only to the individual producing the design might be misleading, as many of the persons involved in the construction process were also professionals.

110. It was noted that paragraph 12 should indicate that an essential prerequisite for adopting this approach was that the design had to be completed before the contract was concluded. It was also noted that the statement that the contractor would not be liable if the

works were not in accordance with the contract was misleading, since in all cases the contractor, in constructing the works, would have to conform to the contractual obligations undertaken by him. It might be preferable to state that the contractor was not responsible for defects resulting from the design supplied by the purchaser. In this connection, the view was expressed that even when the design was supplied by the purchaser, under some legal systems the contractor would be obligated to bring to the attention of the purchaser defects in the design. It was observed, however, that under other legal systems the contractor was not under such an obligation.

111. It was noted that the description of the advantages and disadvantages of this approach (paragraph 13) might need some modification to achieve a proper balance. Thus the possible advantage that the professional preparing the design might not have an incentive to sacrifice certain aspects of the works (e.g. durability, reliability) might be counterbalanced by the possible disadvantage that he might not have an incentive to prepare an economical design. Furthermore, the fact that there might be some disadvantages in this approach might be indicated in the treatment of this approach. However, it was noted that this approach was a species of the approach under which more than one party was engaged to effect the construction, and that the restructured chapter might show that this approach might attract at least some of the disadvantages of the approach under which more than one party was engaged to effect the construction. A view was expressed that an additional advantage of this approach was that it allowed the purchaser to use a multitude of financing sources for the contract. It was also observed that, in paragraph 13, the possibility and advantages of using tendering procedures in relation to the comprehensive contract approach should be distinguished from a description of the approach itself.

112. There was wide agreement that the product-in-hand contract approach was an extension of the turnkey contract approach and should be dealt with as such. However, the differences between the two approaches should also be clarified, and elements which might be common to both approaches (e.g. the operation of the works for a test period and training of the purchaser's personnel) were not useful for identifying the special characteristics of the product-in-hand contract approach. It was also agreed that there was some variety in contractual arrangements which might be described as product-in-hand arrangements. Thus, the obligation of the contractor was sometimes to effect such training as would enable the purchaser's personnel to operate the completed works, but to do so under the guidance of the contractor's managerial personnel. In other cases, his obligation was to make the purchaser's personnel capable of independently operating and managing the works. The parties should be advised to clarify the obligation which the contractor was to undertake.

113. It was observed that the description in paragraph 15 of the advantages and disadvantages of this

approach might be more balanced. Thus the fact that the total cost under this approach might be higher than under the turnkey contract approach should not necessarily be viewed as a disadvantage, because the purchaser obtained more services from the contractor in return for the higher price. Nor was a possible restriction of the purchaser's freedom to select personnel to be trained necessarily a disadvantage, as the purchaser might in fact prefer the contractor to make the choice as the latter might be more qualified to do so. In this connection, it was observed that it might be preferable, instead of listing advantages and disadvantages, to focus on identifying circumstances in which one approach rather than another might be more advantageous to the purchaser.

114. With regard to the separate contracts approach, it was observed that the description of the risk of defects or delays in construction when adopting this approach (paragraph 16) might be balanced by combining it with the description of available methods for reducing this risk (paragraph 21). It was suggested that the advisability of engaging a third person for purposes of co-ordinating the separate contracts needed greater emphasis. The guide should further clarify the different ways in which the responsibility of such a third person might arise (i.e. under the contract or under the applicable law) and the extent of the responsibility which might be imposed on him under the contract. Consideration should also be given to an appropriate term to describe such a third person.

115. The view was expressed that the advantages of this approach referred to in paragraph 18 were open to question and should be reconsidered. It was doubtful if the purchaser retained greater control over the persons involved in the construction, or if he had greater flexibility in making changes in the scope and manner of the construction. The purchaser had a certain degree of freedom to order variations to the scope and manner of construction under any type of contracting approach, and such variations might be easier to execute if only one contractor was engaged.

116. It was observed that, under some legal systems, the contractor was obligated (e.g. because of a duty to act in good faith) to notify the purchaser of defects which he discovered in the design, even if the contract did not impose such an obligation on him. However, it was observed that no such obligation was imposed under other legal systems.

117. With regard to the semi-turnkey contract approach, there was wide agreement that this was a species of the approach under which more than one party was engaged to effect the construction and should be dealt with as such; it was therefore unnecessary to use the term "semi-turnkey contract approach" as a separate subtitle. It was observed that the circumstances in which the use of more than one party to effect the construction might be regarded as a use of the semi-turnkey contract approach and might sometimes be unclear, since there was no general agreement on the characteristic obligations to be assumed by a semi-

turnkey contractor. The Working Group thought it inappropriate to use the term "semi-turnkey" in the Guide other than by reference.

118. It was noted that the obligation of the semi-turnkey contractor to define the scope and quality of the construction as set forth in paragraphs 22 and 23 should be made consistent. It was suggested that what was significant about the portion of the construction undertaken by a semi-turnkey contractor was not the quantity of the construction undertaken, but its importance; accordingly, the word "vital" might be substituted for the word "major" in the first sentence of paragraph 22. It was also observed that clarification was needed (paragraph 24) that the responsibility of the semi-turnkey contractor was only to comply with the contract concluded with him and to deliver works concluded in accordance with that contract.

119. It was observed that the cost comparison between the separate contracts approach in general and the semi-turnkey contract approach (paragraph 25) might be open to question, as the point at issue under the different approaches might only be the different manner in which the purchaser bore the same overall costs. It was also observed that cost comparisons alone might be misleading and that such comparisons should be made together with possible differences in the quality of the works which might be achieved under different contracting approaches.

120. The view was expressed that the Guide should, at an appropriate location, give a description of a contract for the supply of a complete industrial works. Under such a contract, the contractor was usually obligated to provide the design, supply the equipment needed, supervise the erection and be responsible for the quality of the works. However, the erection and the civil engineering might be effected by others.

121. Several suggestions were made for improving the drafting of the chapter.

Completion, take-over and acceptance²⁵

122. It was generally agreed that the various approaches discussed in the chapter should be set forth in a less normative manner and that the secretariat should reconsider its use of the word "should" throughout the chapter. This word should not be used so as to indicate that a certain approach was legally required or that certain consequences flowed automatically from a particular course of action chosen by the parties; rather, it should be used only to indicate matters that the parties should take into consideration in drafting the contract.

123. Various views were expressed concerning the terminology used in the chapter. The secretariat noted that the word "construction", as used in the chapter "Construction on site", encompassed erection, building

and civil engineering, while in this chapter the word was used in a broader sense, covering all of the obligations of the contractor. Views were expressed that while the word could be used in a narrow sense, e.g. referring only to civil engineering, it could also be used to cover a broad range of functions. A further view was expressed that it was not necessary that the word be used in the same sense in every chapter of the Guide, so long as its meaning and usage were clear to the reader in each instance. A suggestion was made that the term "the work of the contract" might be used to refer to everything which was to be done by the contractor. A view was expressed that the phrase "take-over of the work" was preferable to "take-over of construction". It was generally agreed that the secretariat should take note of the problems associated with the word "construction" and should use the term in such a way as to avoid misunderstanding.

124. With respect to the word "erection", a view was expressed that this was a term of art used in connection with works contracts. Other views were expressed, however, that this word was too narrow and was not always used in practice. The word "installation" was suggested as being preferable to "erection". It was generally agreed that the word "installation" should be used in the French version of the chapter. Views were expressed that the word "protocol" should not be used in connection with works contracts; suggestions were made that the words "certificate", "minutes" or "statement" might be used instead. It was noted that what was important in this regard was that the document was to be signed by both parties. It was generally agreed that the term "*procès verbal*" should be used in the French version of the chapter instead of the word "protocol".

125. Views were expressed that certain portions of the chapter were repetitious and that the section "General remarks" should be more generalized. In connection with the last sentence of paragraph 1, a view was expressed that the Guide should clarify the circumstances in which approval would be deemed to be given, and whether such a consequence would arise from the applicable law or whether it should be provided for in the contract. According to an additional view, "erection" should be added to the listing in the first sentence of paragraph 1 of equipment, materials and services, the supply of which would result in the completion of construction, since erection was not usually regarded as the provision of a service.

126. A view was expressed that the Guide should discuss the relationship between the type of contracting approach and completion, take-over and acceptance, since the sequence and application of the latter events would depend upon the type of contracting approach. Such a discussion might require two separate paragraphs, instead of the present paragraph 2. The first sentence of paragraph 2 was viewed as containing an erroneous implication that completion, take-over and acceptance did not all occur in all cases. In this connection, the view was expressed that each of these events would occur in all cases, and the only questions

²⁵A/CN.9/WG.V/WP.15/Add.9.

were when and in which sequence they occurred. According to other views, however, there might be cases in which some of these events would not occur. It was noted with regard to the last sentence of paragraph 3 that take-over would occur even in the case where the purchaser was in physical possession of the plant, since he would have had to take over the plant at some point. According to a further view, take-over would occur in two stages: preliminary take-over, when the guarantee period would commence, and final take-over, at the end of the guarantee period.

127. A view was expressed that the heading of section B of the chapter should be changed so as to reflect more accurately the subject-matter of that section; the heading "Mechanical completion of construction" was suggested. With respect to paragraphs 6 and 7, the view was expressed that the purchaser should be able to require the contractor to perform additional or modified tests and to bear the costs of such tests only if the contract so provided. In this connection, suggestions were made to delete the first sentence of paragraph 6 and the last two sentences of paragraph 7. A further suggestion was made to delete paragraph 6 in its entirety. An additional view was that paragraph 7 should indicate that the contractor might be obligated to bear the costs of additional or modified tests even if they were not standard practice in the industry.

128. In connection with paragraph 6, the observation was made that additional or modified tests presented not only the problem that such tests might damage the works, but also the question of how to deal with the situation where the additional or modified tests revealed defects that were not revealed by the tests provided for in the contract. It was generally agreed that the parties should provide in the contract how such a situation should be resolved.

129. It was noted that much of the discussion in the draft chapter was not applicable to civil works. In this connection, a view was expressed that the Guide should refer only to "completion tests" and not to "mechanical completion tests", since mechanical completion tests would not be conducted in the case of civil works. It was also suggested that the Guide should clarify in which cases it was possible for performance tests to be conducted only after the entire construction had been completed.

130. With respect to a failure of the purchaser to attend mechanical completion tests, a view was expressed that the contractor should be able to conduct the tests in the absence of the purchaser only if the purchaser was not entitled to request a postponement of the tests or did not request such postponement. Moreover, if the purchaser was prevented from attending by a cause for which neither party was responsible, and he so notified the contractor and requested an extension, postponement or repetition of the tests, the costs of extending, postponing or repeating the tests should be borne as set forth in the contract, and each party should bear any additional costs incurred by him. A further view was expressed that the contract should

obligate the parties to co-operate so as to achieve a successful completion of the tests. It was pointed out that the wording of paragraphs 9 and 10 was almost identical to that of paragraphs 24 and 25, and the secretariat was requested to explore means to avoid such repetition, perhaps through the use of appropriate cross-references.

131. It was noted that if an inspecting organization participated in mechanical completion tests, it might recommend changes in the work to which the contractor might not agree, and it was suggested that the contract should provide for a dispute settlement mechanism to deal with this situation. It was generally agreed, however, that since this usually either would involve regulations with which the works must comply or would form the subject of variations which would be ordered by the purchaser, this chapter should merely refer to the chapters in which those subjects were discussed.

132. A view was expressed that paragraph 11 should deal with the nature and role of an inspecting organization participating in mechanical completion tests. According to another view, however, the role of an inspecting organization was only to arrange tests either on behalf of the contractor or of the purchaser, and paragraph 11 should remain as it was drafted at present. It was generally agreed that the expert to whom differences between the parties concerning the readings or evaluation of the tests might be referred, as mentioned in paragraph 12, should be an independent expert agreed to by the parties and named in the contract.

133. A view was expressed that the execution of a mechanical completion test protocol as referred to in the chapter should not discharge the contractor from his responsibility for defects in equipment, materials or the works discovered during the trial operation period, performance tests or the guarantee period. It was generally agreed that the Guide should clarify the relationship between the protocol and the responsibility of the contractor for such defects, and that the chapter should contain a cross-reference to the chapter dealing with the consequences of such defects.

134. A view was expressed that, in addition to specifying items found during mechanical completion tests to be missing, the protocol should specify items found to be defective and the period of time within which such items must be corrected. A view was expressed that the purchaser's signature to the protocol should be dispensed with only when he was not entitled to request a postponement of the tests or did not request such a postponement.

135. It was generally agreed that the contract should clearly indicate when the construction was considered to have been completed. In this connection, a view was expressed that this should be the date of successful completion of mechanical completion tests rather than the date proposed by the contractor for the commencement of the tests. According to another view,

however, since the tests might take a long time, the date of the commencement of the tests might also be considered by the parties.

136. A view was expressed that the main consequence of a failure of the tests to be successfully completed should be that the contractor would be in delay. In this regard, a view was expressed that the last sentence of paragraph 13 should be deleted, as it should not be attempted to regulate in the contract every conceivable situation which might arise. Moreover, the situation referred to in that sentence was usually adequately dealt with by the applicable law. According to another view, however, this sentence should be retained. In this connection a suggestion was made that the issue dealt with in the sentence should be discussed more fully and that such discussion should deal with the consequences of a failure to commence mechanical completion tests as well as of a failure to complete such tests successfully. It was noted that such discussion might be included in a proposed new subsection on the legal consequences of completion.

137. A view was expressed that the difference between take-over and acceptance, and the relationship between them, should be clarified. Take-over was viewed as constituting a physical act by the purchaser (i.e. taking possession of the works), while acceptance was viewed as a legal act (i.e. an indication by the purchaser of his approval of the construction effected by the contractor as being in conformity with the contract). It was noted that take-over and acceptance might occur simultaneously.

138. Various views were expressed regarding the legal effects of take-over and acceptance. With regard to take-over, a view was expressed that the passing of risk of loss of or damage to the works was not the main legal effect, and it was noted that passing of risk might occur even prior to take-over. On the other hand, a view was expressed that the passing of risk was one of the most important legal effects of take-over. A further view was expressed that another important legal effect of take-over might be the commencement of the guarantee period. With regard to acceptance, views were expressed that risk might also pass at the time of acceptance, that the transfer of ownership might occur at that time, and that the guarantee period might also commence at the time of take-over.

139. It was generally agreed that the Guide should adopt a flexible approach to these questions by indicating that the parties might provide for risk to pass at the time of take-over, but that this was only one option which they might consider; they might also consider other solutions, such as providing for risk to pass at the time of transfer of ownership, or at the time of acceptance. Furthermore, the contract might provide for the guarantee period to commence at the time of take-over, or at some other time, such as at the time of acceptance, and for ownership of the works to pass at the time of acceptance. It was noted that the passing of risk of loss of or damage to the works might be influenced by what was provided in the contract with

respect to the passing of risk of loss of or damage to equipment to be incorporated in the works.

140. A view was expressed that take-over might occur before as well as after the trial operation period, and in this connection it was suggested that paragraph 14 should not indicate which of these cases was "usual" or "exceptional". A view was expressed that in the discussion in paragraph 15 of the case where the works remained in the possession of the contractor during the trial operation period, it should be indicated that take-over would occur after the trial operation period. A suggestion was made that the trial operation period should be discussed under a separate heading and that this discussion should deal with which party was to provide labour, materials and feedstock and which party should bear the costs of these items.

141. It was noted that the situation discussed in paragraphs 17 and 18, i.e. take-over in the case of termination of the contract, did not concern the usual cases of take-over, and it was suggested that this discussion should be moved to the chapter "Failure to perform" or another appropriate chapter, with a reference to that chapter contained in the present chapter.

142. With regard to the take-over protocol, a view was expressed that the Guide should distinguish among the various situations in which such a protocol would be required. A further view was expressed that, in addition to the case mentioned in paragraph 19, a take-over protocol would also not be needed if take-over occurred immediately after mechanical completion tests. In this regard it was suggested that reference be made in paragraph 19 to paragraph 12.

143. Views were expressed that the heading of section D should be changed from "Acceptance of construction" to "Acceptance of works" and that paragraph 21 should contain a reference to paragraph 34, dealing with the legal effects of acceptance. A view was also expressed that the last two sentences of paragraph 22, indicating that it might not be possible to test equipment or to put it into operation before the entire construction was completed, should be deleted. A further view was expressed that provisional acceptance was widely used in practice, and its use should not be discouraged by the Guide. A suggestion was made that the meaning of the second sentence of paragraph 23 should be clarified by indicating that the same objectives sought to be achieved by provisional acceptance could also be achieved by providing for take-over after mechanical completion tests, subject to an obligation of the contractor to supply missing items or to remedy defects noted in the take-over protocol.

144. A view was expressed that the discussion of performance tests should clarify whether such tests should seek to ascertain if the works functioned properly, or also if it was capable of producing an output of the required quantity and quality. It was suggested that the possibility mentioned in paragraph 33, that if works could not be tested they might be put

into operation, should be clarified so as to indicate that this referred to the case where the tests could not be performed due to the absence of an inspecting organization.

145. A view was expressed that the contract should provide that if one party did not sign the performance test protocol, the protocol might instead be signed by an expert. It was noted, however, that signature by an expert would not be permitted in all legal systems. It was generally agreed that the Guide should advise the parties to consider whether signature of the protocol by an expert was an approach which should or could be included in their contract. A view was expressed that the contract should set forth a period of time within which the acceptance protocol must be executed by the purchaser, since the time of execution of the protocol might be relevant to certain rights and obligations of the parties, such as the obligation of the purchaser to pay the price.

146. It was generally agreed that it would be helpful to the reader of the Guide if the approaches and documents referred to in the chapter were illustrated. The secretariat was requested to prepare such illustrative provisions and forms, and to consider whether this might permit certain portions of the chapter to be shortened. Various other suggestions were made for improving the drafting of the chapter.

Procedure for concluding contract²⁵

147. It was generally agreed that the issues relating to the procedures for selecting a contractor and for concluding a contract were of great importance to the purchaser and should be discussed in the Guide. However, various views were expressed with respect to the scope of such a discussion. It was noted that the complexity of these issues was such that they could not be exhaustively treated in a chapter of the Guide, since to do so would result in a chapter of disproportionate length. It was also noted that the Commission would consider at its eighteenth session the question of work to be undertaken after the completion of the Guide, designed to enhance further the effectiveness of the Guide, and that the Commission might consider in this connection the preparation of annexes to the Guide, including one on procurement and tendering procedures. A decision to prepare such an annex would be relevant to the scope of the present chapter; however, it was generally agreed that the Working Group should base its consideration of the present chapter on the assumption that the preparation of such an annex would take some time. Taking into account the foregoing considerations, it was generally agreed that the chapter should draw the attention of the purchaser to the matters which he should take into consideration, but that it should not attempt to set forth solutions in detail.

148. A view was expressed that the chapter should deal only with the procedure for selecting a contractor, and not with the formation and entry into force of the contract. According to another view, however, the chapter should also deal with the latter subjects. According to this view, the discussion in particular of the entry into force of the contract should be expanded. On the other hand, it was pointed out that it might be difficult to discuss the formation of the contract in detail, since this matter was often governed by mandatory legislation containing different approaches. It was not necessary to engage in an analysis of the various national legal rules on these issues; rather, the attention of the parties should be drawn to such rules.

149. Different opinions were expressed with respect to the title of the chapter. There was considerable support for the view that the title should correspond more closely to the main issue (i.e. at present, tendering) dealt with in the chapter. However, no decision was taken as to the title which should ultimately be adopted.

150. A view was expressed that the categorization of the open and limited systems of tendering was too sharply defined. There existed a gradation of possible solutions and procedures that might be adopted, ranging from a strictly open tendering system to a limited system as described in the chapter. There also existed a gradation of possible degrees of formality associated with whatever procedure was adopted by the purchaser. Even the negotiation approach involved certain procedural formalities, including the preparation of documents to serve as a basis for negotiations. The view was expressed that the Guide should deal with procedures which the purchaser might adopt for the conduct of such negotiations. It was noted that certain aspects of tendering procedures which might apply when a tenderer was a private enterprise (e.g. a requirement to provide certain documentation) might not apply when the tenderer was a State enterprise.

151. There was considerable support for the view that the discussion of the negotiation approach should be treated on an equal level with that of the tendering approach, taking into account, however, their different natures. The chapter should not convey the impression that tendering was the more important approach to the conclusion of works contracts, since in practice negotiation was also very often used in the conclusion of such contracts. In addition, the chapter should avoid giving the impression that the benefits of competition could not be achieved under the negotiation approach. It was stressed that negotiation often took place with more than one potential contractor.

152. According to one view, negotiation could be engaged in even under the tendering approach. Another view, however, was that such a practice should be discouraged. Furthermore, with the exception of the price, no contractual terms should be left open to discussion between the tenderer and the purchaser. It was pointed out that it might not be practicable to adopt tendering procedures when using the cost-reimbursable method of pricing. Under another view,

²⁵A/CN.9/WG.V/WP.15/Add.10. This document was presented during the session, and it was agreed that this fact should be taken into consideration when the revised version of the chapter was discussed.

tendering procedures could be used even in this case. A view was expressed that the Guide should point out that when the separate contracts approach was used, different procedures might be used in respect of different contracts. A further view was expressed that the Guide should note that under rules of national law or international treaties, tendering might be restricted to contractors from certain countries or regions. It was observed that there might be certain price advantages associated with the open tendering system. It was also observed that under this system the opportunity to tender need not necessarily be accorded to tenderers worldwide.

153. A view was expressed that the chapter should deal in greater detail with criteria which might be used for the evaluation of tenders. It was pointed out that the price might not be the most important criterion and that, in addition to it, the tenderer's capability to perform his obligations, and the responsiveness of his tender to the requirements of the invitation to tender, might also be of great significance. It was suggested that there should be a clearer distinction drawn between the opening of tenders and their evaluation, and that these tasks might be undertaken by different bodies. A view was expressed that the discussion of the "two envelope" system of evaluating tenders should be clarified. It was suggested that the Guide might mention the possibility of the purchaser's rejecting all tenders, but that this should not imply that he could reject one tender otherwise than in accordance with the tender procedures.

154. It was suggested that the chapter should deal with certain issues concerning the legal position of the purchaser and tenderers during the tendering procedures. It was pointed out that the legal positions of the parties would be determined by the applicable law. Views were expressed that it would be advisable to discuss and clarify the legal consequences of making an invitation to tender and submitting a tender. It was observed that under some legal systems a tender might be considered as an offer, and it might be difficult to ensure that the tenderer was not entitled during any particular period to withdraw or change the tender. A view was expressed that the Guide should also discuss the ability of the purchaser to change tender procedures after they had been laid down. It was suggested to expand the discussion of the problems connected with the conclusion of the contract on the basis of tendering procedures. It was noted that financial institutions did not have uniform requirements in respect of tender procedures. A view was expressed, however, that the chapter should not refer to such requirements.

155. Various views were expressed on the depth in which pre-qualification was to be discussed in the chapter. According to one view, the chapter should be confined to a general discussion of the role and merits of pre-qualification (paragraph 9). Under another view, the details to be included in the invitation to apply for

pre-qualification (paragraph 11) and the questionnaire to be sent to enterprises which wished to be pre-qualified (paragraph 12) were very useful for the purchaser and should be retained in the Guide. It was agreed to have an expanded discussion in general terms of pre-qualification, including the reasons why this approach might be used and a description of the steps which might be followed, and to reflect the detailed information contained in paragraphs 10 and 11 in illustrative samples of an invitation to apply for pre-qualification and a pre-qualification questionnaire. It was agreed that the same approach should be followed with respect to the invitation to tender. The secretariat was asked to prepare the illustrative provisions and forms and to include them in the revised draft of the chapter to be discussed at the future session of the Working Group when the revised chapters were discussed as a whole.

156. With respect to the documents to be provided to prospective tenderers, a view was expressed that greater emphasis should be given to contract specifications. In this connection it was also suggested that the chapter should point out that the works must be completely or nearly completely designed by the time tenders were solicited. It was noted that some of the draft forms referred to in paragraph 17 might not be given to prospective tenderers in all cases. A suggestion was made that the chapter should avoid an implication that a performance guarantee was to be submitted by a tenderer with his tender. It was generally agreed that the discussion of the invitation to tender and the instructions to tenderers should not set forth periods of time of a specified duration, but should merely advise the parties to consider what period of time was appropriate.

157. It was noted that tender guarantees were not required in practice in all cases and it was suggested that this should be reflected in paragraph 17. It was also noted that tender guarantees should remain in effect for a certain period after the date until which the tender was to remain in effect. It was suggested that the Guide should not recommend that the tender guarantee should be "high enough", but that it should indicate merely that the purchaser should take into consideration various factors in determining its amount. It was pointed out that the form and contents of certificates of authority might be regulated by the law of the country of a potential tenderer in a mandatory manner, and that it was accordingly not advisable to include such certificates in the list of draft documents mentioned in paragraph 17.

158. Opinions differed concerning whether to delete or retain the subsection "Discussion with most acceptable tenderer". The prevailing view was that the subsection should be retained and the expression "to the satisfaction of the purchaser" in paragraph 32 should be replaced by the term "to the satisfaction of both parties". It was suggested to add to the term

"performance guarantees" in paragraph 34 the expression "if provided for in the tender".

159. It was generally agreed that the Guide should draw the attention of parties to problems connected with the validity of the contract, and that this issue should be elaborated either in this or in another chapter. It was also agreed that the written form for a works contract should be strongly recommended to the parties even in cases where it was not required by the applicable law.

160. It was pointed out that some linguistic revisions were needed in the Arabic version of the chapter, in particular in paragraphs 1 and 5. Some revisions were also needed in the Spanish version of the chapter. Various suggestions were made for improving the drafting of the chapter.

Other business and future work

161. The Secretary of the Commission informed the Working Group that, subject to approval by the Commission, the eighth session of the Working Group was scheduled to be held at Vienna from 17 to 27 March 1986. The Working Group agreed that the secretariat should submit to that session the draft introduction to the Guide and the draft chapters "Identifying project and selection of parties", "General drafting considerations", "Supply of equipment and materials", "Supplies of spare parts and services after construction" and "Settlement of disputes". In addition, if possible, the secretariat might submit a few revised draft chapters which it considered desirable to submit for further careful examination by the Working Group because of the extent of revision required.

2. Draft Legal Guide on drawing up international contracts for construction of industrial works: draft chapters: report of the Secretary-General (A/CN.9/WG.V/WP.15 and Add.1-10)

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[A/CN.9/WG.V/WP.15]

Introduction

1. At its second session, the Working Group on the New International Economic Order decided to request the secretariat to commence the preparation of a legal guide on contracts for the supply and construction of large industrial works.¹ The Commission at its fourteenth session approved this decision by the Working Group and decided that the Guide should identify the

legal issues involved in such contracts and suggest possible solutions to assist parties, in particular from developing countries, in their negotiations.²

2. After having completed at its second³ and third⁴ sessions the consideration of a study submitted by the secretariat of clauses used in contracts for the supply

¹Report of the United Nations Commission on International Trade Law on the work of its fourteenth session, *Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17)*, para. 84.

²A/CN.9/198.

³A/CN.9/217.

⁴A/CN.9/198, para. 92.

and construction of large industrial works,⁵ the Working Group at its third session requested the secretariat to submit to the Working Group an outline of the structure of the Guide and some sample draft chapters.

3. At its fourth session, the Working Group discussed the draft outline of the structure of the Guide and the draft chapters "Choice of contract type", "Exemptions" and "Hardship clauses".⁶ At its fifth session, the Working Group discussed the draft chapters "Termination",⁷ "Inspection and tests", "Failure to perform",⁸ "Variation clauses", "Assignment" and "Suspension of construction" as well as a note on the format of the Guide.⁹ At its sixth session, the Working Group discussed the draft chapters "Damages", "Liquidated damages and penalty clauses",¹⁰ "Scope and quality of works", "Completion, acceptance and take-over", "Allocation of risk of loss or damage", "Insurance", "Sub-contracting" and "Security for performance".¹¹

4. The present report contains in its addenda the following new draft chapters prepared by the secretariat: "Price", Add. 1; "Consulting engineer", Add. 2; "Transfer of technology", Add. 3; "Transfer of ownership of property", Add. 4; "Applicable law", Add. 5; and "Construction on site", Add. 6. In addition, this report contains a revised draft outline of the structure of the Guide, Add. 7, as well as the revised draft chapters "Choice of contracting approach", Add. 8, and "Completion, take-over and acceptance", Add. 9.

5. At its fourth session, the Working Group agreed that, as the work progressed, some rearrangement of the structure of the Guide might become necessary, and the secretariat was given discretion to make such rearrangement.¹² The "Revised draft outline of the structure" reflects such rearrangements. However, since the revised draft outline has not yet been endorsed by the Working Group, the chapters continue to be referred to by title rather than number. The chapters "Choice of contracting approach" and "Completion, take-over and acceptance" are revised versions of the draft chapters "Choice of contract type" (A/CN.9/WG.V/WP.9/Add.2) and "Completion, acceptance and take-over" (A/CN.9/WG.V/WP.13/Add.2), which had previously been discussed by the Working Group.¹³ The substance of the section in the draft chapter "Choice of contract type" entitled "Contract types classified by pricing methods" has been incorporated in the draft chapter "Price" (A/CN.9/WG.V/WP.15/Add.1).

[A/CN.9/WG.V/WP.15/Add.1]

Price

Summary

Three main methods of pricing have been developed in relation to works contracts. These are the lump-sum, cost-reimbursable and unit-price methods. Under the lump-sum method, the purchaser is obligated to pay a certain amount, which remains the same (unless the amount is adjusted or revised) even though the costs of construction turn out to be different to those anticipated at the time of the conclusion of the contract. The lump-sum method protects the purchaser against increases in the costs of construction. However, the lump-sum price may be higher than a cost-reimbursable price for the same construction, since the lump-sum price usually includes an additional amount to protect the contractor against the risk of increases in costs. A disadvantage of the lump-sum method is that it may induce the contractor to reduce his construction costs by using minimal standards of construction (paragraphs 6-9).

Under the cost-reimbursable method, the purchaser is obligated to pay all reasonable costs incurred by the contractor in constructing the works, together with an agreed fee. Under this method, the purchaser bears the risk of an increase in the costs of construction over those anticipated at the time of the conclusion of the contract. In addition, the incentives to economy and speed of completion of construction by the contractor may be reduced, since all costs of construction incurred by the contractor are to be paid by the purchaser. Another disadvantage of the cost-reimbursable method is the burdensome administration connected with its implementation. For these reasons, the cost-reimbursable method should be used in a limited class of cases, e.g. when the extent of construction cannot be anticipated accurately at the time of the conclusion of the contract, or the works to be constructed is of exceptional complexity (paragraphs 10-25). The risk of an increase in construction costs borne by the purchaser may be limited by agreeing upon a ceiling on the total amount of reimbursable costs (paragraph 16). An incentive to economy and speed of completion of construction may be created by a target fee (paragraph 25).

Under the unit-price method, the parties agree on a rate for a unit of construction, and the price is determined by the total units actually used for the construction. The risk of cost increases which occur because the actual quantity of the work exceeds the quantity estimated at the time of the conclusion of the contract is borne by the purchaser, while the risk of increases in the cost of each unit is borne by the contractor (paragraphs 26 and 27).

Two or all three pricing methods may be combined in a works contract and used for pricing the construction of the works or a portion of the works.

⁵A/CN.9/WG.V/WP.4 and Add.1-8; A/CN.9/WG.V/WP.7 and Add.1-6.

⁶A/CN.9/WG.V/WP.9 and Add.1-4.

⁷A/CN.9/WG.V/WP.9/Add.5.

⁸A/CN.9/WG.V/WP.11/Add.1 and 3.

⁹A/CN.9/WG.V/WP.11/Add.6-9.

¹⁰A/CN.9/WG.V/WP.11/Add.4 and 5.

¹¹A/CN.9/WG.V/WP.13/Add.1-6.

¹²A/CN.9/234, para. 13.

¹³*Ibid.*, para. 36, and A/CN.9/259, para. 61.

If the purchaser is interested in completion of construction earlier than envisaged in the contract, bonus payments in addition to the price may be agreed in the contract (paragraphs 28 and 29).

Fluctuations in the exchange rate of the currency in which the price is determined may create certain risks for the parties. The parties may wish to take steps to reduce this risk and to allocate it in an appropriate way between the parties (paragraphs 30-36).

Even if a lump-sum price or unit-price rates are agreed, the parties may wish to envisage specific situations where the price is to be adjusted or revised. An adjustment of the price may be needed in cases where the nature or extent of construction work is changed (paragraphs 40-46). A revision of the price may be needed where some economic or financial factors change after the conclusion of the contract so as to bring about a change in the relationship between the values of the performances by the parties (e.g. increases or decreases in construction costs or changes in the value of the price currency in relation to other currencies). The revision of the price due to a change in construction costs may be effected on the basis of an index clause, and changes in specified price indices may be relevant (paragraphs 49-55).

Another approach may be to use the documentary proof method and base the revision on the change in actual construction costs. This approach may, however, be appropriate for use only in cases where an index clause cannot be used, and should be limited to portions of the price based on unstable factors. The revision should cover only a change in costs actually incurred by the contractor as compared to his costs estimated at the time of the conclusion of the contract, and should not cover an increase in costs due to an underestimation of the scope of construction at the time of the conclusion of the contract. Revision should occur not only in case of an increase, but also in case of a decrease in costs (paragraphs 56 and 57).

Changes in the exchange rate of the price currency in relation to other currencies may be dealt with through a currency clause (paragraphs 58 and 59) or a unit-of-account clause (paragraphs 60-62).

The payment conditions in the contract should provide for specified percentages of the price to be payable at different stages of construction. They should also stipulate modalities of payment and indicate the place of payment (paragraph 63).

An advance payment by the purchaser should be limited to the portion of the price reasonably needed to cover the contractor's expenses in the initial stages of the construction and protect him against loss in the event of termination of the contract in the initial stages (paragraphs 65 and 66).

Payment of portions of the price may depend upon the progress of construction. Specified sums may be payable upon completion of defined portions of the

construction, or the contractor may be entitled to receive payments for construction commensurate with the amounts of construction completed within specified periods of time (paragraphs 67-72).

A certain percentage of the price may be payable upon proof that construction has been successfully completed (paragraph 73), with the remainder of the price payable only after expiry of the guarantee period (paragraphs 74 and 75). If a credit is granted by the contractor to the purchaser, the portion of the price covered by the credit may be payable in instalments within a certain period of time after proof of satisfactory completion of construction (paragraphs 76-78).

* * *

A. General remarks

1. The formulation of contractual provisions relating to the price to be paid by the purchaser must take into account a number of factors. The price may cover different types of performances by the contractor, e.g. the supply of equipment, materials and services, and the transfer of technology. A considerable period of time may elapse from the conclusion of the contract until completion of construction, and during this period there is a possibility of changes in construction costs, both in respect of the construction to be effected by the contractor himself and that to be effected by sub-contractors. In addition, the extent of construction to be effected is sometimes not precisely determinable at the time of the conclusion of the contract. The parties should decide who is to bear the consequences of changes in costs and reflect their decision in the contract terms.

2. Three main methods of pricing are in common use in works contracts. These are the lump-sum, cost-reimbursable and unit-price methods. However, in appropriate circumstances, two or all three methods may be used in combination for pricing the construction of the works or a portion of the works.

(a) *Lump-sum method:* under this method, the parties agree on the amount to be paid for the construction (see paras. 6-9, below). Subject to possible adjustment (see section E, 1, below) or revision (see section E, 2, below) in special circumstances, this amount remains the same even though the cost of construction turns out to be different from that anticipated at the time of the conclusion of the contract.

(b) *Cost-reimbursable method:* under this method, the purchaser is obligated to pay all reasonable costs incurred by the contractor in constructing the works, together with an agreed fee (see paras. 10-25, below).

(c) *Unit-price method:* under this method, the parties agree on a rate for a unit of construction, and the price is determined by the total number of units actually used for the construction (see paras. 26 and 27, below).

3. Under the lump-sum method, the risk of an increase in the costs of construction is borne by the contractor (except to the extent that the price is subject under the contract to adjustment or revision), and under the cost-reimbursable method, by the purchaser. Under the unit-price method, it is allocated to both parties (see para. 27, below).

4. Legal systems adopt different approaches when the price, or a method for determining the price, is not specified in the contract. Under some legal systems, the contract is invalid, while under other legal systems the contract remains valid and the price is determinable under the rules of the legal system. Since the rules under some legal systems for determining the price in the absence of an agreed price may not be appropriate to works contracts, and in order to reduce uncertainty as to the price, it is advisable for the parties to determine the price, or agree on a method for determining the price, in the contract.

5. In drafting the payment conditions in a works contract (see section F, below), the parties should consider applicable foreign exchange, tax and other regulations of a public nature. The violation of such regulations may result in the invalidity of the contract or of some of its provisions. Special problems which may arise in connection with the price to be paid for the transfer of technology are discussed in the chapter "Transfer of technology".

B. *Methods of pricing*

1. *Lump-sum method*

6. Under the lump-sum method, the contractor is entitled only to the price determined in the contract, irrespective of the actual costs incurred by him during the construction. The mere use of the term "lump-sum price" may, however, be insufficient under the applicable law to achieve this result. Accordingly, the contract should contain clear provisions to this effect. The parties, however, sometimes provide for an adjustment or revision of the price in certain defined circumstances (see paras. 36-62, below). The lump-sum method of pricing is usually used in turnkey contracts (see paras. 15 and 26, below, and the chapter "Choice of contract type"). It is also frequently used when the separate contracts approach is chosen, in particular in cases where at the time of the conclusion of the contract the extent of construction is known and significant changes in the scope and quality of the works at a later stage are not anticipated.

7. The lump-sum amount is the price for the entire performance to be effected by the contractor. For practical reasons, it may, however, be advisable to break down the lump-sum into the amounts payable for different portions of the works, or the amounts payable for equipment, for materials, for different kinds of services and for the transfer of technology. Such a breakdown may facilitate adjustment of the price in

certain cases envisaged in the contract (for example in case of a variation of a portion of the construction: see the chapter "Variation clauses"). In addition, such a breakdown is needed if different payment conditions are agreed on for different portions of the works or for different kinds of performances by the contractor (e.g. supplies of equipment, or training: see para. 63, below). Tax legislation or other regulations of a public nature may also require some breakdown of the price, e.g. specifying the portion of the price to be paid for a transfer of technology (see the chapter, "Transfer of technology").

8. The main advantage of the lump-sum method of pricing for the purchaser is that the contractor bears the risk of increases in the cost of construction. Subject to a price adjustment or price revision clause included in the contract, the purchaser does not have to pay more than the amount fixed in the contract. He is, however, obligated to pay this amount even if the costs incurred by the contractor turn out to be lower than anticipated at the time of the conclusion of the contract. Another advantage of a lump-sum contract for the purchaser is that the administration of such a contract may be somewhat less burdensome than if the unit-price method or, in particular, the cost-reimbursable method were adopted. Under the unit-price method, measurement of the extent of work completed and, under the cost-reimbursable method, verification of the costs incurred by the contractor are essential to determine the price to be paid.

9. In calculating a lump-sum price, the contractor usually includes an increment in addition to his estimated costs and his profits in order to protect himself against the risk of an increase in costs. The lump-sum price may therefore be higher than a cost-reimbursable price for the same construction, provided that in executing the cost-reimbursable contract the purchaser or his consulting engineer is able to ensure an economical choice by the contractor of sub-contractors and of equipment and materials, as well as efficient procedures for construction. Another disadvantage of the lump-sum method for the purchaser is the potential motivation for the contractor to reduce his construction costs by using minimal standards of construction. The lump-sum method requires, therefore, a precise determination in the contract of the scope and quality of the works and some monitoring by the purchaser of the standards of construction.

2. *Cost-reimbursable method*

10. If the cost-reimbursable method is used by the parties, the exact amount of the price is not known at the time of the conclusion of the contract, since the price will consist of the actual costs of construction incurred by the contractor and a fee to be paid to him to cover his overheads and profit. This method of pricing, therefore, requires more detailed contractual provisions than the lump-sum method.

11. The cost-reimbursable method may be appropriate in a limited class of cases. Thus, it may be appropriate when the extent of work or materials and the kinds of equipment needed for the construction cannot be accurately anticipated at the time of the conclusion of the contract (e.g. where the works has not been completely designed because of the speed at which construction has to be commenced, or where the construction requires substantial underground work and underground conditions cannot be accurately predicted), or where the major part of the construction is to be done by sub-contractors and the prices to be charged by them are not known at the time of the conclusion of the contract. This method may also sometimes be used where the construction of the works involves unusual difficulties (e.g. special design or complex engineering). In such cases there would be many unknown factors affecting pricing, and a lump-sum price would have to be highly inflated in order to protect the contractor against his risks.

12. The main disadvantage of the cost-reimbursable method for the purchaser is that he bears the risk of an increase in the costs of construction over those anticipated at the time of the conclusion of the contract. Furthermore, since all costs of construction incurred by the contractor are to be paid by the purchaser, the incentives to economy and speed of completion of construction by the contractor may be substantially reduced. Financing institutions are therefore usually opposed to this method of pricing. In order to protect the purchaser, the contractor should be obligated to construct the works efficiently and economically and be entitled to the costs of construction only if they are reasonable. In practice, however, it may be difficult to enforce such general obligations. As further protection, the contract may require the participation of the purchaser or his engineer in the selection of sub-contractors, or at least approval by the purchaser or his engineer of the prices of equipment, materials or services to be supplied by third parties (see the chapter "Sub-contracting"). In addition, the parties may agree upon a ceiling on the total amount of reimbursable costs (see para. 16, below), and the fee of the contractor may be fixed in a manner that gives him an incentive to minimize the costs of construction (see para. 25, below).

13. In some cases the parties may wish to provide that the purchaser is to be entitled to require conversion of a cost-reimbursable price into a lump-sum price. The contract may provide that at any time before the completion of construction the purchaser may request the contractor to quote a lump-sum for which the contractor is prepared to complete the construction which is then outstanding and not paid for. However, the contractor should be obligated to submit such a quotation only when it is reasonably possible for him to do so, having regard to the nature of the construction to be effected. If the purchaser accepts the quotation submitted, the cost-reimbursable price would be converted into a lump-sum price. If the quotation is not acceptable to the purchaser, the original cost-reimbursable price would continue to subsist.

14. To ensure a smooth operation of the cost-reimbursable method, a system of record-keeping should be adopted which would accurately evidence the costs incurred by the contractor. The contractor should be obligated to maintain records in accordance with the forms and procedures reasonably required by the purchaser, reflecting charges incurred and payments effected by the contractor.

15. The cost-reimbursable method may not be appropriate for a turnkey contract. An essential aspect of a turnkey contract is that the contractor assumes responsibility for constructing works which will operate in accordance with the contract. He will usually assume such a responsibility only if he is allowed freely to choose his sub-contractors. However, under the cost-reimbursable method, the purchaser may wish to participate in the selection of sub-contractors (see para. 12, above).

16. The risk borne by the purchaser of an increase in construction costs may be limited by agreeing upon a ceiling on the total amount of reimbursable costs. If the costs incurred turn out to be lower than the ceiling, the purchaser will only be obligated to pay such incurred costs. A contractor who agrees to such a ceiling, however, may increase his fee so as to protect himself against the risk he is bearing of an increase in costs beyond the ceiling.

17. Another approach may be for the parties to agree at the time of the conclusion of the contract upon an estimate of the costs of construction (i.e. a "target cost") without, however, providing that this target cost is to constitute a ceiling on the total amount of reimbursable costs. They may then provide that, if the actual costs exceed the target cost, the contractor is to be paid only a percentage of the excess. It may also be provided that this percentage is to decrease as the excess increases. Alternatively, the parties may agree that, if the target cost is exceeded, the purchaser may terminate the contract without being liable to the contractor for costs incurred by the contractor incidental to the termination. This right of the purchaser to terminate may give the contractor an incentive to keep his costs within the estimate. Under this alternative, however, the purchaser may face the difficulty of having either to refrain from terminating the contract and to proceed with construction by the contractor, with an obligation to pay him all reimbursable costs exceeding the target cost, or to terminate the contract and complete the construction by engaging another contractor.

18. The contract should identify those kinds of costs which are to be reimbursed. Since it may be difficult to identify the totality of costs which may arise in connection with construction, it is advisable to enumerate the costs to be reimbursed and to provide that all other costs are to be borne by the contractor, or vice versa.

19. Certain overhead expenses of the contractor (e.g. those connected with the head office of the contractor)

should be considered as covered by his fee and excluded from the costs which are to be reimbursed by the purchaser. In defining when wages paid to the contractor's personnel are to be reimbursable, the contract may provide that only wages of the personnel on the site are to be reimbursable, while the wages of personnel at the contractor's head office are to be considered as overhead expenses covered by the fee. Disputes may arise on how to value smaller items of equipment or materials taken from the contractor's store, as they may have been bought by the contractor at various prices before commencement of the construction. Such disputes may be prevented by agreement in advance on their prices. Costs of repairing defects for which the contractor is responsible should be borne by him.

20. Costs incurred in employing sub-contractors and suppliers should include only costs actually paid by the contractor, taking into account all discounts granted to the contractor by sub-contractors and suppliers. The contract should determine whether discounts granted to the contractor against payments in cash by the contractor should also be taken into account.

21. Smooth and continuous construction requires that all the necessary materials be available on the site in accordance with the time schedule. In some cases, however, it may be very difficult to envisage the precise quantities needed for construction. Over-ordering may occur, and losses may be incurred in connection with the resale of excess materials. The contract may set a limit on the extent to which such losses are to be reimbursed by the purchaser.

22. Under some contracts, certain equipment, materials or services to be used in the construction may be supplied by the purchaser and paid for by the contractor. If in such cases the contract fixes a ceiling on the reimbursable costs (see para. 16, above) or fixes a target cost (see paras. 17, above and 25, below), the question may arise whether, in determining if the ceiling or target cost has been reached, the price paid by the contractor is to be taken into account. This question should be settled in the contract.

23. The fee to be paid to the contractor may be a fixed amount. If there are variations affecting the extent of construction, the contractor's fee may require an adjustment, and the contract should provide a mechanism therefor (see the chapter "Variation clauses").

24. A fixed fee gives no incentive to the contractor to minimize his costs of construction. An alternative approach may be to agree only on a method of determining the fee at a later stage, taking into account the actual extent and costs of construction. However, this approach should be adopted only in exceptional cases, as it may provide an incentive to the contractor to increase the costs of construction. This method of determining the fee is forbidden under some legal systems.

25. The most advisable method of determining the contractor's fee is to fix a "target fee", which is a percentage of the target cost. If the reimbursable costs are less than the target cost, the target fee would be increased by a specified percentage of the saved cost. The contract may provide that, as the saved costs increase, the percentage payable is also to increase. If, however, the reimbursable costs are more than the target cost, the target fee would be decreased by a specified percentage of the excess in cost. The contract may provide that as the excess increases, the percentage to be deducted is also to increase. In addition to the costs of construction, other aspects may be regarded as relevant in increasing or decreasing the target fee, such as the time taken to complete construction, and the performance of the completed works (e.g. its consumption of raw materials or energy). It may be noted that providing an incentive to the contractor to lower the costs of construction by varying the fee payable may be combined with an incentive based on an obligation to share the costs of construction when they exceed a target cost.

3. Unit-price method

26. If the unit-price method is used, the amount of the entire price is not known at the time of the conclusion of the contract, since the parties agree only on a rate for a construction unit, and the price to be paid is dependent upon the number of construction units used for the construction. The rate fixed for a construction unit would include the contractor's profit. The construction unit may be a quantity unit of materials (e.g. a ton of cement for concreting) or a time unit of construction (e.g. an hour spent by labour in excavation work) or a quantity unit of construction work (e.g. a cubic meter of reinforced concrete). Different construction units may be needed for different portions of the construction (e.g. material units for construction of buildings and time units for erection of equipment). Wherever feasible at the time of the conclusion of the contract, an estimate should be made of the number of units needed for the construction. In most cases the unit-price method is used only in combination with other pricing methods, since it is not suitable for pricing aspects of the construction which by their nature cannot be divided into several identical units. It is unsuitable, for example, for pricing a delivery of equipment when the items of equipment are dissimilar. This method is frequently used in respect of civil engineering. It is also useful where the quantity of materials or the quantity of work needed for a portion of the construction cannot be envisaged accurately at the time of the conclusion of the contract, and for this reason it is difficult for the parties to determine a lump-sum price. The unit price method may not be advisable in a contract in which it is difficult to control the quantities of units to be used for the construction. In a turnkey contract, in particular, the purchaser or his advisers may be unable to predict at the time of the conclusion of the contract even approximately the quantities involved, since the techniques of construction are usually left to the discretion of the contractor.

Accordingly, the purchaser may face a high degree of uncertainty as to the final price.

27. In applying the unit-price method, the risk of price increases is divided between the contractor and the purchaser. Since the price per construction unit is firm, the contractor bears the risk of an increase of the costs of materials and labour. The risk of an increase of price due to an increase in the quantities of units needed for the construction over the estimate made at the time of the conclusion of the contract is borne by the purchaser. Accordingly, the contractor should not have to add to his price an amount to protect himself against possible increases in quantities. The risk to the purchaser of an increase of price due to an increase of the quantities of units needed for the construction may be reduced if the parties provide a ceiling. Under this approach, the contract may provide that the purchaser would have to pay for quantities up to the amount of the ceiling, but that the contractor would have to bear the costs, or a specified percentage of the costs, of an increase of quantities beyond the ceiling. Since the price payable by the purchaser depends on the number of units needed for the construction, the parties should agree on clear rules on measurement in order to avoid disputes. Furthermore, it would be desirable to agree upon simple units which are easily measurable.

C. Bonus payment

28. In many cases the purchaser is interested in the completion of construction and the commencement of the operation of the works as early as possible. He may, therefore, be ready to pay a higher price in the form of a bonus payment if construction is successfully completed by the contractor prior to the date fixed for completion in the contract. The amount of the bonus may be established so as to represent a share of the estimated profit of the purchaser due to an earlier commencement of the operation of the works.

29. For the calculation of the bonus, the parties may determine such share of the estimated profit to be represented by a given sum of money for each day of earlier completion. This amount of money per day may then be expressed as a percentage of the price if the lump-sum method of pricing is used or as a percentage of the fee if the cost-reimbursable method of pricing is used. Representing the bonus payment as a percentage of the price or fee will enable the amount of the bonus to change if the price or fee changes (e.g. due to adjustment or revision of the price, or cost savings in comparison with the target cost). If the unit-price method is used, the amount may remain as a fixed amount per day of earlier completion. The bonus payment may be limited to a maximum amount. Furthermore, payment should be due only after a specified period of continuous operation of the works. This approach may deter the contractor from adopting methods of construction which are less time-consuming but which result in defective construction. The period of time for continuous operation of the works may commence to run at the time of take-over or acceptance

of the works by the purchaser (see the chapter "Completion, take-over and acceptance"). The contract may provide that delay in the successful completion of construction is to entail the payment by the contractor of liquidated damages or penalties (see the chapter "Liquidated damages and penalty clauses").

D. Currency of price

30. The currency in which the price is determined may create certain risks for the parties. If the price is determined in the currency of the contractor's country, the purchaser bears the consequences of a change in the exchange rate between this currency and the currency of his country. The contractor, however, will bear the consequences of a change in the exchange rate between the currency of his country and the currency of another country in which he has to pay some of the costs of construction (e.g. payments to subcontractors). If the price is determined in the currency of the purchaser's country, the contractor bears the consequences of a change in the exchange rate between this currency and the currency of his country. If the price is determined in the currency of a third country which the parties consider to be stable, each party bears the consequences of a change in the exchange rate between this currency and the currency of his country. Where a financing institution has granted the purchaser a loan for the construction of the works, the purchaser may prefer the price to be determined in the currency in which the loan is granted.

31. In stipulating the currency in which the price is to be paid, the parties should take into consideration foreign exchange regulations and international treaties which may mandatorily govern this question. In particular, they should consider treaties which may regulate payments between their respective countries and require that payment be made in a certain currency, or prescribe a certain form in which payments are to be effected (e.g. through a clearing arrangement between the two countries).

32. In cases where the parties use the lump-sum method or unit-price method, the risk borne by the contractor of changes in the exchange rate of the price currency will be reduced if the price is determined in the same currencies in which his payments of costs connected with the construction are expected to be effected. If this approach is adopted various portions of the price may be determined in different currencies. The contractor may also reduce the risk borne by him of changes in the exchange rate of the price currency by using the price currency under the works contract as the price currency under sub-contracts. However, the contractor will bear even in these cases the consequences of a change in the exchange rate of the price currency occurring in the period between the date when he bought the price currency to pay for costs incurred by him and the date when the price is paid by the purchaser in respect of the costs.

33. If the parties use the cost-reimbursable pricing method, the contract may stipulate that the costs should be reimbursed in the same currency as the fee. If this approach is adopted and costs are incurred in a currency other than the currency of the fee, the costs must be converted into the currency of the fee at an exchange rate. The contract should provide that the exchange rate prevailing at a specified place on a specified date is to be used. The date may be either the date on which the costs were incurred by the contractor or the date of payment of these costs by the purchaser to the contractor. It may alternatively be provided that the costs should be reimbursed in the same currency in which they are incurred by the contractor.

34. A purchaser from a country which has scarce foreign exchange resources may have an interest in ensuring that at least a part of the price is to be paid in the currency of his country. Thus, the currency of the purchaser may be used for payment in respect of those costs of construction which are incurred by the contractor in the purchaser's currency (e.g. payment of local labour or sub-contractors, or costs of accommodation of the contractor's personnel in the purchaser's country). Such arrangements may be made even in cases where the lump-sum pricing method is used in the contract. One approach may be to fix at the time of the conclusion of the contract the part of the price to be paid in local currency, on the basis of an estimate of the costs to be incurred by the contractor in local currency. Another approach is for the parties to provide a lump-sum in a foreign currency for the whole contract, but provide that costs incurred in the local currency will, after they are ascertained, be paid in the local currency and be deducted from the lump-sum at a specified exchange rate.

35. If the parties agree in the contract that the price fixed in a currency which the parties consider to be stable is to be paid at an agreed exchange rate in another currency, similar effects may in substance be achieved as by agreeing upon a currency clause (see para. 58, below). Restrictions imposed by the applicable law in respect of currency clauses may also apply to such provisions. In such cases, the parties should agree on the exchange rate which is to apply between the currency in which the price is determined and the currency in which the price is to be paid. The exchange rate should be defined by reference to the rate prevailing at a specified place on a specified date. If the price is determined on a lump-sum or unit-price basis, the contractor may prefer that the contract specify that the relevant date is to be the date when the payment of the price is actually effected. If the price is determined on a cost-reimbursable basis, one of the dates referred to in para. 33, above, may be specified.

36. It is not advisable to use clauses under which the price is denominated in several currencies, and either the debtor or the creditor is entitled to decide in which currency the price is to be paid. Under such a clause only the party having the choice is protected, and the choice may bring him unjustified gains.

E. Adjustment and revision of price

37. Due to the long-term and complex nature of a works contract, the parties frequently agree that the price may be adjusted or revised in specified situations, even if the price is a lump-sum or rates are determined for construction units. If the cost-reimbursable method of pricing is used, such an adjustment or revision is usually needed only in respect of the fee, since this method makes allowance for changes in construction costs which would otherwise need to be covered by an adjustment or revision clause.

38. The terminology used in the Guide distinguishes between "adjustment" and "revision" of the price. Adjustment refers to cases where the price may need to be changed because the nature or extent of construction work is changed. Revision refers to cases where, although the nature or extent of construction work is unchanged, the price may need to be changed because some economic or financial factors change after the conclusion of the contract so as to bring about a modification in the relationship between the values of the performances by the parties. For example, the costs of equipment or materials to be used by the contractor for construction of the works may change considerably from that envisaged at the time of the conclusion of the contract, or the value of the price currency may change in relation to other currencies after the conclusion of the contract. Adjustment or revision of the price may result in an increase or decrease of the price, although experience shows that an increase is more usual.

39. In providing for the adjustment or revision of the price, two approaches are possible. Under the first approach (which is dealt with in detail in the chapter "Settlement of disputes"), the contract would obligate the parties to agree upon an adjustment or revision. The contract would also provide that if they fail to do so, a court, or arbitrators, or a third person authorized by the parties is entitled to make the adjustment or revision. Under some legal systems, however, a court or arbitrators cannot, in substitution for the parties, modify any contractual provisions. Furthermore, even if this mechanism is permissible under the applicable law, there will be some uncertainty as to the extent of the adjustment or revision which might be made. Another approach (see subsections 1 and 2, below), may be to stipulate in the contract a method under which the price adjustment or revision, rather than being dependent upon the parties' agreement, is determined under some criteria specified in the contract. The latter approach is, in general, permissible under most legal systems and may be so formulated as to reduce uncertainty as to the extent of adjustment or revision. Thus, in regard to adjustment, the contract may provide that the price is to be adjusted by the inclusion of costs reasonably incurred by the contractor in specified circumstances. In regard to revision, the contract may provide that the price is to be revised in accordance with a specified mathematical formula or to make allowance for costs reasonably incurred.

1. *Adjustment of price*

40. The parties may wish to define carefully the circumstances in which the price determined in the contract is to be adjusted, since uncertainty as to the price will otherwise occur. In addition, a contract intended to be a lump-sum contract may tend to take on the nature of a cost-reimbursable contract if adjustment is possible in a wide range of circumstances.

41. An adjustment of the price is frequently needed if there is a variation of the construction. Adjustment of the price in such cases is discussed in the chapter "Variation clauses". In some situations, the contractor may be obligated to modify his performance even without the application of variation procedures. Some contractual provisions dealing with consequential price adjustment in those situations may be needed.

(a) *Incorrect data supplied by purchaser*

42. The parties may wish to agree that the price is to be adjusted in cases where, as a result of incorrect data supplied by the purchaser, additional or more expensive work has to be effected in comparison with the work reasonably envisaged at the time of the conclusion of the contract. However, the parties may wish to provide that the price is not to be adjusted if the contractor could reasonably have discovered the incorrectness of the data at the time of the conclusion of the contract. The price adjustment should cover the costs which the contractor reasonably incurred in order to rectify errors resulting from the incorrect data. The parties may also wish to provide that, in cases where the incorrectness of the data could not reasonably have been discovered at the time of the conclusion of the contract, the price is not to be adjusted unless the contractor subsequently discovered the incorrectness of the data at the time they could reasonably have been discovered and gave notification of the errors at that time to the purchaser.

(b) *Unforeseeable hydrological and sub-surface conditions*

43. The contractor is normally expected to inspect the site and its surroundings, to the extent practicable, before submitting a tender or negotiating a contract, and to base his negotiations on the findings made at such an inspection. It may, however, not be possible during such an inspection, even with the exercise of reasonable efforts, to discover certain physical conditions on the site, in particular hydrological and sub-surface conditions. Different approaches may be adopted in cases where during construction hydrological and sub-surface conditions are encountered which could not reasonably have been discovered by the contractor during his inspection. The risk of such conditions may be placed on the contractor, and he may be obligated to bear the extra costs incurred as a result of the unforeseeable conditions. An alternative approach may be to provide that the price is to be increased by the higher costs reasonably incurred by the contractor due to the conditions encountered.

(c) *Changes in local regulations*

44. Certain administrative rules or other rules of a public nature of the purchaser's or the contractor's country may mandatorily regulate certain aspects of the works or the methods of construction (e.g. in the interests of safety or for environmental protection; see the chapter "Applicable law"). If the portion of the construction already completed, or the construction to be effected, does not accord with such rules, whether existing at the time of the conclusion of the contract or enacted thereafter, changes in the construction may be needed. The contract should determine in what cases the price is to be adjusted.

45. The contract may provide that the contractor is not entitled to any adjustment of the price if the change is required as a result of a rule of the contractor's country. If the change is required as a result of a rule of the purchaser's country which existed at the time of the conclusion of the contract, the price should not be adjusted unless the purchaser had assumed in the contract an obligation to inform the contractor of all such rules and he had failed to satisfy his obligation. In the event of a failure by the purchaser to give information, the contract may provide that the price is to be increased by the higher costs reasonably incurred by the contractor in making the change.

46. The contract should specify who is to bear the risk of changes required by rules enacted in the purchaser's country after the conclusion of the contract. If the risk is to be borne by the purchaser, the price should be adjusted.

2. *Revision of price*

47. Under most legal systems, the principle of "nominalism" is applied to payments, i.e. an amount of currency to be paid is not automatically increased or decreased in case the value of the currency of payment has changed between the time the payment obligation was assumed and the time it has to be discharged. The value of currency may be subject to change between the time of conclusion of the contract and the time of payment in terms of its exchange rate in relation to other currencies. It may also be subject to change in terms of its purchasing power, with the result that the construction costs of the contractor may increase or, in exceptional cases, decrease. Many long-term contracts contain clauses directed at reducing the risk borne by the contractor of a change in the value of currency. Such clauses may provide for revision of the price on the basis of indices (see paras. 49-55, below) or on the basis of costs actually incurred (see paras. 56 and 57, below). However, contractual provisions concerning price revision due to a change in the value of the price currency are mandatorily regulated under many legal systems. The parties should, therefore, examine whether a clause which they intend to include in the contract is permitted under the law of the country of each party.

48. If the parties agree on a clause for price revision, it is advisable that such a clause should apply under the

contract only in cases where its application would result in a significant revision of the price, e.g. a revision exceeding a certain percentage of the price. In practice, the percentage stipulated ranges from 5 to 10 per cent. Price revision clauses are usually not used where the duration of construction as determined in the contract is less than 12 to 18 months from the coming into force of the contract.

(a) *Change in costs of construction*

(i) *Index clauses*

49. Index clauses usually link the amount of a lump-sum price to the levels of the prices of certain goods or services prevailing on a certain date, with the result that a change in the latter levels as indicated in specified price indices relating to those goods and services causes a corresponding change in the amount of the contract price. In works contracts, the contract price is usually linked to the levels of the prices of materials or services (e.g. labour) needed for the construction of the works. The purpose of index clauses is to reflect in the contract price changes in the costs of construction. A change in the agreed indices effects a change in the price. There is no necessity to examine the actual prices paid by the contractor during construction. Under the laws of some countries, index clauses are permitted only for the purpose of dealing with changes in construction costs occurring between the time the contract is concluded and its coming into force. Index clauses usually use an algebraic formula to determine how changes in the specified indices are to be reflected in the price.

50. The index clause should not apply to all portions of the price. Thus, it should not apply to the portion of the price paid in advance, since the advance payment is intended to be used by the contractor within a short period of time after the conclusion of the contract to cover the contractor's working capital and expenses in the initial stages of construction (see para. 65, below). It should also not apply to any portion of the price payable on the basis of the costs of construction prevailing at the time of construction. It may also be provided that the index clause is not to apply to changes in costs resulting from changes in taxes and customs duties payable by the contractor in the country of the site. In such cases the price may be revised on the basis of actual costs incurred by the contractor (see the chapter "Supplies of equipment and materials"). A ceiling on the extent to which the price may be increased or decreased through price revision may also be agreed upon.

51. In drafting an index clause, several indices, with different weightings given to each index, are often used in combination in a formula in order to reflect the contribution of different cost elements (e.g. materials or services) to the total cost of construction (i.e. separate indices reflecting the costs of different materials and services may be contained in a single formula). Separate indices will also have to be used when the sources of the same cost element are in different countries. Often, separate formulae, each with its own weightings, may be used for different construction operations. If, for

instance, the construction involves a number of dissimilar types of operations, such as excavation, concreting, brickwork, erection, and dredging, a single price revision formula may be difficult to draft and may produce inaccurate results. It may therefore be preferable to have a separate formula for each main item of the construction.

52. An index clause usually includes a certain percentage of the price (commonly 5-20 per cent) which is not subject to any revision under the clause. This percentage is intended to make allowance for the fact that some items may be paid for by the contractor at a lower price level than that reflected in the price index for those items. This percentage may also afford some protection against other inaccuracies resulting from the formula used in the clause. In addition, if the aim of the index clause is to protect the contractor only against higher costs of construction and not against inflation in general, this percentage may reflect the contractor's profit. The inclusion in the clause of such a percentage also creates an incentive for the contractor to try to protect himself against price increases (e.g. by making purchases at appropriate times).

53. Whether a price revision is needed should be determined at the time of each interim payment. In order to use the agreed indices, the contract should specify the dates to be used for comparing the levels of the indices. The contract may provide that the base levels of the indices are to be those existing on the date the contract was concluded. Alternatively, when the contract is concluded on the basis of tendering, the contract may provide that the base levels of the indices are to be those existing a specified number of days (e.g. 45 days) prior to the submission of the contract bid, or those existing a specified number of days prior to the closing date for the submission of bids. The contract should also provide that these base levels are to be compared with the levels of the same indices existing a specified number of days prior to the last date of the period of construction in respect of which payment is to be made. It may alternatively be provided that the base levels are to be compared with the levels existing a specified number of days prior to the date on which payment is due. If the contractor is in delay with completion of the construction, it may be provided that the levels of the agreed indices existing a specified number of days prior to the agreed date for performance should be used, if these levels are more favourable for the purchaser.

54. Several factors may be relevant in deciding on the indices to be used. The indices should be readily available (e.g. they should be published at regular intervals). They should be accurate. Indices published by recognized bodies (such as well-established chambers of commerce) or governmental or intergovernmental agencies may be selected. Where certain construction costs are to be incurred by the contractor in a particular country, it may be advisable to use the indices of that country.

55. In some countries, particularly in developing countries, the range of indices available for use in an index clause may be limited. If an index is not available for a material to be used in the construction, the parties may wish to use an index available in respect of another material. This material should be such that its price is likely to change in the same proportions and at the same times as the actual material to be used (e.g. because it is composed of the same raw material or can be used as an alternative to the actual material to be used). For example, if there is no wage index available, a consumer price index (or cost-of-living index) is sometimes used as a "proxy index".¹

(ii) *Documentary proof method*

56. In some contracts, a method often referred to as the documentary proof method is used to deal with changes which may occur after the conclusion of the contract in certain specified costs connected with the construction. The documentary proof method is based on the principle that the contractor is to be paid the amount by which actual costs connected with the construction exceed the costs upon which the calculation of the price determined in the contract was based, due to changes in the price levels which existed at the time of conclusion of the contract. This method contains disadvantages for the purchaser. Even if a lump-sum contract is agreed upon, the purchaser has to pay for all increases in construction costs due to

increases in the prices of equipment, materials, or labour. It may be difficult to ascertain at a later stage the costs upon which the calculation of the contract price was based. In addition, the contractor may have little incentive to keep down the costs of construction. The administrative work needed by the contractor to obtain documentary proof of the costs of construction, and by the purchaser to verify such costs, may be almost as extensive as under a cost-reimbursable contract. The documentary proof method should be used only in respect of portions of the price calculated on the basis of unstable cost factors where the index clause method (see paras. 49-55, above) cannot be used (e.g. where relevant indices are not available).

57. If the parties wish to use the documentary proof method, they should specify in the contract the portion of the price that is subject to revision (e.g. the portion payable during the course of construction). The contract should also identify the equipment, materials or services in respect of which revision of the price is to take place and separately state the amount of the costs relating to such equipment, materials or services upon which the contract price relating to such items was based. A revision of the price should occur not only in case of an increase but also in case of a decrease in costs. The contractor should be obligated to prove the costs actually incurred by him, and the contract should set forth procedures, similar to those which are to be used under a cost-reimbursable contract (see para. 14, above), for proving such costs. Furthermore, a revision of price should occur only by reason of a change in the costs actually incurred by the contractor due to a change in the prices of equipment, materials and services. A revision should not occur in respect of higher costs incurred due to an underestimation by the contractor of the scope of his construction obligations at the time of the conclusion of the contract. The contract may also provide that an increase of the actual costs over the estimated costs is to result in a price revision only if the increase exceeds a certain percentage of the estimated costs (see para. 48, above) and the contractor is to be entitled to only a certain percentage of the increase. Furthermore, the contract may require the contractor to purchase equipment or materials in respect of which price revision is permitted from approved sources, or after obtaining competitive bids.

(b) *Change in exchange rate of price currency in relation to other currencies*

(i) *Currency clause*

58. Under a currency clause, the price to be paid is linked to an exchange rate determined at the time of the conclusion of the contract between the price currency and a certain other currency (referred to as "the reference currency"). If this rate of exchange has changed at the time of payment, the price to be paid is increased or reduced in the ratio that the exchange rate determined at the time of the conclusion of the contract bears to the exchange rate prevailing at the time of actual payment. It may be desirable to adopt, for purposes of comparison, the time of actual payment rather than the time payment falls due. If the latter time

¹*Illustrative provision (index clause)*

"(1) The agreed price shall be revised if there is an increase or decrease in the costs of ... (list materials or services to be covered by this clause). The revision shall be made by the application of the formula contained in the annex to this contract (see appendix to this chapter). The price, however, shall not be revised if the increase or decrease of the price resulting from the application of the formula does not exceed ... per cent of the agreed price.

"(2) The base levels of the indices shall be those existing [at the time of the conclusion of the contract] [... days prior to the actual submission of the bid] [... days prior to the closing date for the submission of bids]. These levels shall be compared with the levels of the same indices existing [... days prior to the last day of the period of construction in respect of which payment is to be made] [... days prior to the date on which the payment claimed is due]. However, if the contractor is in delay in construction, the base levels shall, at the purchaser's option, be compared with the levels existing ... days prior to the agreed date for performance.

"(3) The portion of the price subject to revision shall be ... per cent of the price for the construction of ... (indicate items of construction work to be covered by this clause) effected during the construction period in respect of which the payment is to be made.

"(4) No revision shall be made in respect of that portion of the price paid by the purchaser in advance.

"(5) Where any portion of the price to be paid to the contractor is to be determined on the basis of the actual costs incurred by the contractor in effecting performance, such portion of the price shall not be subject to revision.

"(6) If a dispute arises between the parties with regard to the weightings in the formula, the weightings shall be adjusted by [the engineer] [the arbitrators] [the court] if they have been rendered unreasonable or inapplicable as a result of changes in the nature and extent of construction.

"(7) For the purposes of this provision the indices published by ... in ... (indicate the country) shall be used. If these indices cease to be available, other indices shall be used if they can reasonably be expected to reflect price changes in respect of the construction costs covered by this clause."

is adopted, the contractor may suffer a loss if the purchaser delays in payment. The place whose exchange rate is to be later taken into consideration should be specified.

59. If a currency clause is to serve its purpose, the reference currency must be stable. The insecurity arising from the potential instability of a single reference currency may be reduced by reference to several currencies. The contract may determine an arithmetic average of the exchange rates between the price currency and several other specified currencies, and provide for revision of the price in accordance with changes in this average.

(ii) *Unit-of-account clause*

60. If a unit of account clause is used, the price is denominated in a unit of account composed of cumulative proportions of a number of selected currencies. The unit of account is usually defined in an international treaty or by an international organization, and the definition specifies the selected currencies and the relative weighting given to each currency making up the unit. In contrast to a currency clause in which several currencies are used, the weighting given to each selected currency of which the unit of account is composed is not the same, and greater weight is usually given to currencies generally used in international trade.²

61. The main advantage of using a unit of account as the currency unit with which the price currency is to be compared is that a unit of account is relatively stable, since the weakness of one currency is usually balanced by the strength of another currency of which the unit of account is composed. A unit of account clause will therefore give substantial protection against changes in exchange rates of the price currency in relation to other currencies.

62. In choosing a unit of account to be used in a clause, the parties should consider whether the relation between the price currency and the unit of account can be easily determined at the relevant times, i.e. at the time of the conclusion of the contract and at the time of payment. The unit of account defined by the International Monetary Fund as the Special Drawing Right (SDR) is sometimes used. The value of this unit of account in terms of a number of currencies is published periodically by the International Monetary Fund.

F. *Payment conditions*

63. Payment conditions express, in time sequence, the relationship of the obligations to be performed by the parties, i.e. the construction of the works by the

contractor and the payment of the price by the purchaser. Under many contracts, a lump-sum price payable is broken down and allocated against major items of the performance to be effected by the contractor (e.g. civil engineering, supply of equipment, transfer of technology). Under most payment conditions, the portions of the price in respect of such major items are payable at different stages in specified percentages, for example, in respect of the supply of equipment, 10 per cent as an advance payment (see paras. 65-66, below), 70 per cent during construction (see paras. 67-72, below), 10 per cent after take-over or acceptance of the works (see para. 73, below), and 10 per cent after expiry of the guarantee period (see paras. 74-75, below). These specified percentages may differ in respect of the different major items. Payment conditions usually also stipulate modalities of payment (e.g. a letter of credit, or the documents against which payment is to be made). The place of payment may also have significant legal consequences, in particular in determining which party bears the risk of changes in the value of currency during transfers of funds (e.g. where the place of payment is in the purchaser's country and the funds are transferred to the contractor's country), and in determining the applicable foreign exchange restrictions.

64. Payment conditions may influence the amount of the price. If the contractor has to finance the construction because the price is only payable upon the completion of construction, he will usually charge a higher price. On the other hand, if the contractor is paid more than the value of performances effected by him, he may have less incentive to continue to perform promptly. The purchaser, therefore, usually pays the contractor a substantial portion of the price progressively as various steps in the construction are completed. Payment conditions should contain ancillary provisions appropriate to the chosen pricing method. Thus, a cost-reimbursable contract should provide procedures for the verification of costs incurred by the contractor prior to payment, and a contract using the unit-price method should provide procedures for the measurement of construction effected.

1. *Advance payment*

65. An advance payment is usually required under a works contract to cover the contractor's working capital and expenses in the initial stages of the construction (e.g. for purchase of construction machinery, transport and accommodation of personnel, and initial purchases of equipment and materials). Such payment may also provide to the contractor some protection against loss in the event of a termination of the contract by the purchaser prior to the commencement, or at an early stage, of the construction. The purchaser is usually protected by a guarantee against failure by the contractor to repay the advance (see the chapter "Security for performance"). The amount of the advance payment may be calculated so as to cover the initial expenses of the contractor which are anticipated.

² *Illustrative provision*

"The price is agreed upon subject to the condition that . . . (indicate a unit of account) is equal to . . . (indicate unit or units of the price currency). Should this relationship have changed at the time of the actual payment of the price by more than . . . per cent, the price to be paid shall be increased or decreased so as to reflect the new relationship between the unit of account and the unit of the price currency."

66. The advance payment is usually to be directly remitted by the purchaser to a bank designated by the contractor, upon the provision by the contractor of the performance and repayment guarantees (see the chapter "Security for performance").

2. *Payment during construction*

67. Payment conditions usually provide for the payment of a substantial portion of the price in accordance with the progress of construction. Sometimes such payment is also linked to the manufacture of equipment. The amount to be paid during construction should be determined taking into consideration the nature of the construction effected and the pricing method adopted.

68. One approach to determining the time and extent of payment may be to identify specific portions of the construction (e.g. excavation, or construction of the foundations), and provide that specified sums are to be payable upon completion of those portions. An alternative approach frequently used is to provide that the contractor is entitled to receive progress payments for the construction completed within specified periods of time (e.g. every month), the extent of the payment depending upon the extent of construction effected within that period.

69. Equipment and materials supplied by the contractor may be paid for after their incorporation in the works, as part of the construction effected, under one or other of the approaches described in the preceding paragraph. The parties may, however, agree on another approach, particularly in cases where the equipment and materials are taken over by the purchaser after their delivery and are in his possession until their use for construction. In these cases the portion of the price in respect of such equipment and materials may be payable against documents proving that they have been handed over to the first carrier for transmission to the purchaser, or that they have been delivered to the site (see the chapter "Supply of equipment and materials").

70. Since payments during construction are to be effected in respect of construction already completed, the parties should clearly agree upon the procedures (e.g. measurement) for determining such completion. The purchaser may wish to authorize the consulting engineer to check the extent of the completed construction. To obtain a progress payment, the contractor may be required under the contract to submit to the consulting engineer at the end of each payment period certain documents supported by a detailed report concerning the construction completed in the relevant payment period. Payments may be effected on the basis of interim certificates issued by the consulting engineer or the purchaser.

71. The contract should specify the documents which the contractor is obliged to submit to obtain payment, such as his invoice, bills of lading, certificates of origin, packing lists, and inspection certificates. The documents to be required may depend upon the time and

manner of performance. Different documents may be required in respect of supplies of equipment, materials, or services. The documents required may also differ depending on the method of pricing used by the parties (e.g. if the cost-reimbursable method is used, documents proving that the contractor solicited a specified number of offers for the sale of equipment and materials to be used in the construction, and accepted the best offer).

72. The contract should specify a period of time within which an interim certificate for payment is to be issued by the consulting engineer or the purchaser and a period of time after issuance of this certificate within which payment is to be effected by the purchaser. The portion of the price due under the certificate may be payable upon submission of the certificate to a bank to be specified in the contract. In case of a failure to issue the certificate even though the event entitling the contractor to payment has occurred, or to pay the amount due under the certificate, the contractor should be entitled to claim payment in dispute settlement proceedings (see the chapter "Settlement of disputes").

3. *Payment after take-over or acceptance of works*

73. Certain percentages of some portions of the price (e.g. for supply of equipment and materials, civil engineering, erection, or transfer of technology) may be payable only upon proof that construction has been successfully completed (e.g. after acceptance of the works). The contract should stipulate that the purchaser is to pay such portions of the price within a certain period of time after such proof (e.g. within two weeks after successful performance tests have been conducted or an acceptance protocol has been signed; see the chapter "Completion, take-over and acceptance"). In some cases a portion of the price may be made payable within a specified period of time after take-over of the works (see the chapter "Completion, take-over and acceptance").

4. *Payment after expiration of guarantee period*

74. To protect the purchaser against the consequences of defective construction by the contractor, the contract may provide that a certain percentage of the price is payable only after expiry of the guarantee period (see the chapter "Failure to perform"). In fixing the percentage to be paid after expiry of the guarantee period, the parties should take into account the other securities which are available to the purchaser in case of the discovery of defects during the guarantee period. If the purchaser is sufficiently protected by a performance guarantee (see the chapter "Security for performance"), it may be provided that the entire price is payable at the time of the acceptance of the works.

75. The contract should specify a period of time commencing to run on the expiry of the guarantee period within which the purchaser is obliged to pay the portion of the price then outstanding. However, if any

defects are discovered and notified within the guarantee period, the purchaser should be entitled to retain from the portion of the price then outstanding an amount which is sufficient to compensate him for the defects. This right of retention should exist until the contractor cures the defects and pays any damages to which the purchaser may be entitled.

5. Credit granted by contractor or contractor's country

76. In most cases the construction of works is financed by a financing institution on the basis of a loan granted by it to the purchaser. However, in some cases where the contractor has at his disposal ample financial resources, and the works to be constructed is not large, the contractor may be ready to grant a credit to the purchaser in respect of a portion of the price. In such cases, the portion of the price covered by the credit is usually to be repaid by instalments within a specified period of time after take-over or acceptance of the works by the purchaser.

77. Where the contractor grants such a credit to the purchaser, some of the issues which are settled in a separate loan agreement when a loan is granted by a financing institution (e.g. security for repayment of the loan by the purchaser and interest payable on the loan) need to be settled in the works contract.

78. The construction of works is sometimes financed by using a credit granted by the Government of the contractor's country to the Government of the purchaser's country. In these cases the parties should, when drafting the payment conditions, take into consideration the provisions of the agreement between the Governments and the rules which may be issued in the purchaser's country in connection with the implementation of the agreement (e.g. conditions under which the credit may be used for construction).

Appendix

Formula for revising agreed price*

The price revision envisaged in clause ... of this contract shall be made by the application of the following formula:

$$P_1 = \frac{P_0}{100} \left(a + b \frac{M_1}{M_0} + c \frac{N_1}{N_0} + d \frac{O_1}{O_0} + e \frac{W_1}{W_0} \right)$$

where:

P_1 = Price payable under clause ...;

P_0 = Initial price to which clause ... is to be applied;

M_1, N_1, O_1, W_1 = Index levels for the various cost elements (e.g. materials and services) covered by

clause ... prevailing at the relevant time before payment (see paragraph (2) of the illustrative provision);

M_0, N_0, O_0, W_0 = Base index levels of the same cost elements prevailing at the time of the conclusion of the contract, or at an agreed point of time prior to the conclusion of the contract (see paragraph (2) of the illustrative provision);

a = Percentage of price excluded from price adjustment (see paragraph (3) of the illustrative provision);

b, c, d, e = Weightings given to the various indices, reflecting the proportions in which the various cost elements contribute to the costs of construction covered by the index clause;

$a + b + c + d + e = 100$.

[A/CN.9/WG.V/WP.15/Add.2]

Consulting engineer

Summary

A consulting engineer as dealt with in this chapter is an engineering firm engaged by the purchaser to render advice and technical expertise to the purchaser, to take certain actions under the works contract on behalf of the purchaser, or to exercise certain independent functions under the contract (paragraphs 1 and 2). The works contract should set forth clearly the authority and functions of the consulting engineer to the extent that they affect the rights and obligations of the contractor (paragraph 3). The contract need not authorize or regulate the rendering by the consulting engineer of advice and technical expertise to the purchaser (paragraphs 4 and 5). It should, however, set forth any authority of the consulting engineer to act on behalf of the purchaser, including any limitations on such authority (paragraphs 6 and 7).

In some works contracts the parties may wish to provide for a consulting engineer to exercise certain functions independently, rather than for or on behalf of the purchaser. Such independent functions may include resolving on-site technical questions arising during the course of construction, certifying the existence of certain facts giving rise to rights and obligations under the contract or determining the existence of such rights and obligations, or deciding upon disputes between the parties. The parties may consider it desirable that the consulting engineer not be authorized to decide upon disputes arising from services supplied or work performed by him (paragraphs 8 to 10).

The contract should establish the extent to which an act or decision of the consulting engineer pursuant to an independent function is to be considered binding on the parties. In this respect the contract should provide that all acts or decisions taken by the consulting engineer pursuant to his independent functions are subject to review in arbitral or judicial proceedings. It would be desirable for the contract to provide that an

*This formula is adapted from a formula set forth in *ECE General Conditions for the Supply and Erection of Plant and Machinery for Import and Export*, No. 188A (United Nations publication, Sales No. 1957.11.E/Mim.3).

act or decision of the consulting engineer which is subject to review must be complied with until it is modified or reversed in arbitral or judicial proceedings, and that the contractor is entitled to compensation for additional work performed or costs incurred by him as a result of conforming to or complying with the act or decision. The parties might, however, consider whether the arbitral or judicial tribunal should be given discretion to decide that an act or decision of the consulting engineer is not to be conformed to or complied with pending the outcome of the proceedings (paragraphs 12 and 13).

The consulting engineer usually should be named in the invitation to tender and in the works contract. The parties may also wish to consider whether, in the event that a consulting engineer exercising independent functions must be replaced while the construction is in progress, the selection of the new consulting engineer should be left exclusively to the purchaser, or whether the contractor should be able to participate in the selection of a new consulting engineer proposed by the purchaser. If the contractor is to be entitled to participate in the selection of a new consulting engineer, the contract should provide for appropriate procedures to enable him to do so (paragraphs 14 to 16).

It may be desirable for the contract to provide that the consulting engineer may not delegate his authority to exercise independent functions to a third person who is not his employee without the written consent of both parties (paragraphs 17 and 18).

The parties should agree upon the extent to which the consulting engineer should have access to information, the site, places of manufacture of equipment, materials and supplies to be incorporated in the works, the plant under construction and the completed works, in order to enable him to perform his functions effectively (paragraph 19).

* * *

A. General remarks

1. The purchaser will require the services of an engineer from the early stages of an industrial works project. The services which an engineer might render prior to the conclusion of the works contract may include, for example, making feasibility and other pre-contract studies, preparing the design, drawings and specifications for portions or all of the works, preparing tender and contract documents, handling tendering procedures and advising the purchaser on various other technical matters. After the contract has been entered into, the purchaser will continue to rely on an engineer to provide advice and technical and managerial expertise in connection with the construction of the works. In some cases, an engineer may be authorized to take on behalf of the purchaser various actions provided for by the works contract. In addition, an engineer may be authorized to exercise certain independent functions which directly affect the rights and obligations of both parties to the contract.

2. In some cases a purchaser may have on his own staff engineers who are capable of supplying the various services which the purchaser will require in connection with the construction of the works. In other cases, however, the purchaser's staff may not be able to supply all the engineering services required, and the purchaser will have to engage an engineering firm in order to obtain such services. Such a third-party firm is referred to in this chapter as the "consulting engineer". Even in cases where the purchaser's in-house engineering capabilities are sufficient, the purchaser may wish to engage a consulting engineer in order to supplement these capabilities, for example, where a consulting engineer has particular expertise or experience in the implementation of similar projects. In addition, if the works contract provides for certain independent functions to be exercised by an engineer, the contract will usually require that these functions be exercised by a consulting engineer rather than by engineers on the staff of the purchaser.

3. This chapter deals with provisions in the works contract with respect to the authority and functions of a consulting engineer who is engaged by the purchaser. While such authority and functions will be established by the contract between the consulting engineer and the purchaser, the works contract should set forth clearly such authority and functions to the extent that they affect the rights and obligations of the contractor. This will enable the contractor to know when he may rely on or must give effect to acts or decisions taken by the consulting engineer. In addition, doubts as to whether such acts or decisions are within the scope of the authority of the consulting engineer will thereby be avoided.

B. Authority and functions of consulting engineer

1. Rendering services to purchaser

(a) Rendering advice and technical expertise to purchaser

4. With any type of works contract, it is important for the purchaser to possess or to have access to the technical expertise necessary to satisfy himself that the design and specifications for the works meet his requirements and that the work is progressing satisfactorily, and to take the various decisions and exercise the other functions which are within his province under the contract. For example, he must be able to approve the construction time schedule submitted by the contractor, monitor the progress of the construction, assess the performance of the contractor in order to determine whether to make payments claimed to be due by the contractor, evaluate delays or defects in construction and determine what measures to take in that regard, order variations or decide upon variations proposed by the contractor, decide upon sub-contractors proposed by the contractor, deal with exempting impediments or hardship situations and evaluate the results of inspections and tests. In certain contracts it may be necessary for the purchaser to contract for supplies and equipment, check and evaluate drawings submitted by the

contractor, evaluate guarantees proffered by contractors and suppliers and schedule and co-ordinate work performed by various contractors. In a cost-reimbursable contract, it will be necessary for the purchaser to ascertain whether the costs of items for which the contractor seeks reimbursement are reasonable and correct. In a unit-price contract, the purchaser will have to verify the amount of units of materials or labour used. The purchaser will often engage a consulting engineer to advise him and render technical expertise as to all these matters.

5. Since the mere rendering by the consulting engineer of such advice and expertise to the purchaser will not directly affect the contractor's contractual rights and obligations, there is no need for the works contract to authorize or regulate the exercise of such functions by the consulting engineer. On the other hand, it may be desirable for the contract to contain provisions designed to enable or facilitate the exercise of such functions, such as provisions granting the consulting engineer access to the site or place of manufacture or information necessary to monitor the progress of the work and exercise his other functions (see para. 19, below).

(b) *Acting on behalf of purchaser*

6. In addition to rendering advice and technical expertise to the purchaser, a consulting engineer may be authorized to take, on behalf of the purchaser, some or all of the acts of the nature referred to in para. 4, above. In such cases, since the acts by the consulting engineer may directly affect the contractor's contractual rights and obligations, the contract should set forth the authority of the consulting engineer to take such acts, including any limitations upon such authority (e.g. any restrictions on the authority of the engineer to order or agree to variations on behalf of the purchaser). In addition, the contract should oblige the purchaser to notify the contractor in writing of any addition to or change in the authority of the consulting engineer effected after the contract has been entered into. The types of acts to be taken by the consulting engineer on behalf of the purchaser will vary depending upon the nature of the contract. In a turnkey contract, the acts to be taken by the consulting engineer will normally be more limited than under less comprehensive types of contracts.

7. The contract should also specify any authority of the consulting engineer to communicate with the contractor on behalf of the purchaser. For example, the contract may provide for communications between the purchaser and the contractor dealing with matters within the authority of the consulting engineer to be transmitted through the engineer.

2. *Independent functions*

8. In some works contracts, the parties may wish to provide for a consulting engineer to exercise certain functions independently rather than for or on behalf of the purchaser. Such independent functions may be of

various types. For example, the parties may consider it desirable for a consulting engineer to be on site to be able expeditiously to answer technical questions which arise during the course of construction, to resolve discrepancies, errors or omissions in the drawings or specifications or to interpret technical provisions of the contract. In addition, the parties might in some cases wish to authorize the consulting engineer to certify the existence of certain facts which would give rise to rights or obligations under the contract, or also to determine the existence of such rights or obligations. The following are examples of such functions:

Certify the entitlement of the contractor to payments claimed by him;

Certify the existence of a delay or other failure to perform;

Certify the occurrence and duration of events asserted to be exempting impediments, or also determine that such events do constitute exempting impediments (see the chapter "Exemptions");

Certify the existence of circumstances asserted as grounds to justify suspension of construction or order suspension of construction (see the chapter "Suspension of construction");

Certify whether mechanical completion tests or performance tests are successful or whether additional or modified tests should be performed (see the chapter "Inspection and tests");

Certify the existence of circumstances asserted as grounds to justify termination of the contract (see the chapter "Termination");

Certify the existence of circumstances asserted by the contractor as a ground for objecting to a variation ordered by the purchaser, or decide whether a variation should be performed (see the chapter "Variation clauses");

Determine the consequences of variations upon the contract price and the time for completion by the contractor (*ibid.*);

Certify the existence of circumstances asserted as giving rise to rights under a hardship clause, or determine that a situation of hardship exists (see the chapter "Hardship clauses");

Assist the parties in re-negotiations under a hardship clause, or adapt the contract if the parties to re-negotiations are unable to agree on an adaptation (*ibid.*);

Determine the amount of additional time for performance to which the contractor is entitled as a result of a suspension of construction by the purchaser or for other reasons (see the chapters "Suspension of construction" and "Completion, take-over and acceptance").

9. The contract might provide for matters such as those referred to in the previous paragraph to be submitted directly to the consulting engineer for his action, either in the context of a dispute between the parties or otherwise. For example, the contract might provide for a claim by the contractor for payment to be

submitted to the consulting engineer for his certification, together with the bills or accounts in support of the claim. Or, the contract might authorize the consulting engineer to resolve a dispute between the parties as to whether the contractor is entitled to payment (unless the dispute arises from a failure of the consulting engineer to certify payment claimed to be due by the contractor; see para. 10, below). The parties might also in some cases wish to authorize the consulting engineer to decide upon disputes between the parties as to matters additional to those referred to in the previous paragraph. Reference of disputes to the consulting engineer could provide a more expeditious means for dealing with the disputes than referring them directly for resolution by arbitration or judicial proceedings. It would enable the disputes to be dealt with by someone who is involved in and knowledgeable about the project, and who would be aware of most or all of the relevant correspondence and arguments.

10. The parties may wish to consider whether the consulting engineer should be authorized to decide upon all disputes between the parties concerning the project, or only those disputes involving matters within the competence and expertise of the consulting engineer, i.e. disputes concerning technical matters relating to the scope, quality and construction of the works. In the latter event, the parties may wish to specify more precisely the types of disputes upon which the consulting engineer may decide. The parties may consider it desirable, however, for the consulting engineer not to be authorized to decide upon disputes arising from services supplied or work performed by him (e.g. disputes concerning a design supplied by him) or from actions which he has taken pursuant to the contract or which, although authorized to take, he has failed to take (e.g. disputes arising from his issuance or failure to issue a certificate of payment).

11. If the consulting engineer is to be authorized to exercise independent functions, even though he may be selected or engaged by the purchaser it may be desirable for the contract to provide that these functions are to be exercised impartially as between the purchaser and the contractor. Moreover, the parties may wish to provide in the contract that, in the exercise of independent functions other than those that involve simply finding or certifying the existence of facts or events, the consulting engineer is to apply and give effect to the provisions of the contract and not simply to act in accordance with his own conception of fairness and without regard to the provisions of the contract.

12. The contract should establish the extent to which an act or decision of the consulting engineer pursuant to an independent function is to be considered binding on the parties. In this respect the contract should provide that any such act or decision may be referred by either party for review in arbitral or judicial proceedings. The contract might also provide that any matter upon which the consulting engineer has failed to take an act or decision within a specified period of time after having been requested by a party to do so may be referred to such proceedings, unless the contract pro-

vides another means of dealing with the matter (e.g. by providing that a certification is deemed to have been made).

13. It would be desirable for the contract to provide that an act or decision of the consulting engineer which is subject to review must be conformed to or complied with until it is modified or reversed in arbitral and judicial proceedings, in order to avoid lengthy and costly interruptions in the construction. However, the contract should entitle the contractor to be compensated by the purchaser for any additional work performed or costs incurred by the contractor, not otherwise provided for in the contract, as a result of conforming to an act or complying with a decision of the consulting engineer, even if the act or decision is subsequently modified or reversed in arbitral or judicial proceedings. The parties might consider whether it is desirable to provide that the arbitral or judicial tribunal may, at its discretion, decide that an act or decision of the consulting engineer is not to be conformed to or complied with pending the outcome of the proceedings.

C. Selection and replacement of consulting engineer

14. When a consulting engineer has been retained to render pre-contract services to the purchaser (see para. 1, above), he will normally continue as the consulting engineer under the contract, even if he is to perform independent functions. The consulting engineer usually should be named in the invitation to tender so that tendering contractors are aware that he must be accepted as the consulting engineer under the works contract. The consulting engineer should also be named in the works contract.

15. The parties may wish to consider whether, in the event that a consulting engineer must be replaced while the construction is in progress, the selection of the new consulting engineer should be left exclusively to the purchaser or whether the contractor should be able to participate in the selection of a new consulting engineer proposed by the purchaser. If the new consulting engineer is only to render technical advice and assistance to the purchaser or to act on behalf of the purchaser, he should be chosen by the purchaser alone. If he is to exercise independent functions, the contract might provide either that the new consulting engineer is to be chosen by the purchaser alone, or that the contractor is entitled to participate in the choice. It may be noted, however, that some international lending agencies will not permit the contractor to participate in the choice in projects which are financed by them.

16. When a new consulting engineer who is to act on behalf of the purchaser or is to exercise independent functions is to be chosen by the purchaser alone, the contract should obligate the purchaser to deliver to the contractor written notice of the name and address of the new consulting engineer. Where the contractor is to participate in the selection of a new consulting engineer, the contract should require the purchaser to inform the contractor of the proposed new consulting engineer and seek the contractor's approval thereof. The purchaser

should be permitted to engage the proposed new consulting engineer if within a specified period of time after delivery of the notice the contractor does not deliver to the purchaser an objection to the proposed new consulting engineer, specifying the grounds for his objection. The contract may further provide that any objection by the contractor to the new consulting engineer proposed by the purchaser must be based upon reasonable grounds. If the contractor objects to the new consulting engineer proposed by the purchaser, but the purchaser is of the view that the contractor's objection is not based upon reasonable grounds, the dispute should be resolved under the dispute settlement machinery contained in the contract. If the contractor's objection is found not to be based upon reasonable grounds, the purchaser should be entitled to engage the new consulting engineer proposed by him. On the other hand, if the contractor's objection is found to be reasonable, the purchaser should be obliged to propose another consulting engineer.

D. Delegation of authority by consulting engineer

17. In cases where the consulting engineer is to exercise independent functions, the parties may consider it desirable to provide that he may not delegate his authority to exercise such functions to another consulting engineer who is not his employee without the written consent of both parties. Such a restriction should be contained both in the purchaser's contract with the consulting engineer and in the works contract. Similarly, in cases where the consulting engineer is to act on behalf of the purchaser, any limitations which the purchaser may wish to impose upon the ability of the consulting engineer to delegate his authority to exercise such functions should be contained both in the purchaser's contract with the consulting engineer and in the works contract, so that the contractor is made aware of such limitations. However, the ability of the consulting engineer to allocate his authority among individual engineers employed by him should not be limited. For example, a consulting engineer may designate a site representative to exercise day-to-day activities but may deal with more substantial matters at a higher level within the management hierarchy of the consulting engineering firm.

18. The contract might also provide that any acts of a consulting engineer to whom authority has been delegated with the appropriate consent by the consulting engineer named in or engaged under the provisions of the contract shall have the same effect as if the acts had been taken by the original consulting engineer. It might also provide that the original consulting engineer may take any act which the consulting engineer to whom authority has been delegated is authorized to take but has not taken (e.g. to order the cure of defects).

E. Information and access to be provided to consulting engineer

19. In order to enable the consulting engineer to exercise his functions effectively, he may need to have

various types of information, as well as access to the site, access to the places of manufacture of equipment, materials and supplies to be incorporated in the works, and access to the plant under construction and to the completed works. The parties should agree upon the extent to which the contractor is obligated to provide such information or grant such access to the consulting engineer. He should normally have as a minimum the degree of access which is accorded to the purchaser under the contract.

[A/CN.9/WG.V/WP.15/Add.3]

Transfer of technology

Summary

The purchaser will require a knowledge of the industrial processes necessary for production embodied in the works, and require the technical information and skills necessary for the operation, maintenance and repair of the works. The communication to the purchaser of this knowledge, information and skills is often referred to as the transfer of technology (paragraph 1).

Different contractual arrangements can be entered into for the construction of the works and the transfer of technology (paragraph 2). The transfer of technology itself may occur in different ways. It may occur, for example, by acquiring an understanding of the nature and functioning of the works (paragraph 3), through the licensing of industrial property (paragraph 4) or the communication of confidential know-how (paragraph 5). The information and skills necessary for the operation, maintenance and repair of the works may be communicated through documents, or through the training of the purchaser's personnel (paragraph 6).

The Guide does not attempt to deal comprehensively with the licensing of industrial property or the communication of know-how, and this chapter merely notes certain issues which the parties should address when a works contract involves industrial property or know-how (paragraph 7). In drafting contract provisions relating to the transfer of technology, the parties should take account of mandatory legislation regulating such transfer which may be in force in the purchaser's and contractor's countries (paragraph 8).

Some issues which the parties should address are common both to licensing and know-how provisions. Thus the technology to be transferred should be carefully described (paragraph 9). When agreeing upon restrictions to be imposed on the purchaser's use of the technology, the parties should take account of legislation which may mandatorily regulate such restrictions (paragraph 10).

The guarantees to be given by the contractor may depend on the contractual arrangements in question, and may range from an unqualified guarantee that the works will operate in accordance with specified para-

meters to a qualified guarantee that the works will operate in accordance with specified parameters provided certain conditions are satisfied (paragraphs 11 and 12). Special forms of payment of the price (e.g. payment of royalties) have evolved with regard to licensing and know-how provisions (paragraphs 13 to 15).

The parties may wish to include in the contract an undertaking by the contractor that the industrial property or know-how transferred does not infringe the rights of a third party. The contract should specify the remedies which are to be available in the event that such an infringement occurs (paragraphs 16 and 17).

An issue special to know-how provisions is confidentiality. The contractor will wish to obligate the purchaser to maintain confidentiality in respect of the know-how communicated. The extent to which confidentiality is imposed should be clearly defined in the contract. Furthermore, the contract should provide for situations in which the purchaser may reasonably need to disclose the know-how to third parties (paragraphs 18 and 19).

When technical information and skills are conveyed through documents, the contract should address several issues in regard to the documents. Such issues include the description of the documents to be supplied, demonstrations needed to explain the documents, and the times at which the documents are to be supplied (paragraphs 20 to 22).

The most significant method of conveying technical information and skills is by the training of the personnel of the purchaser. The contractor should be obligated to supply the purchaser with a statement of the personnel requirements for the operation, maintenance and repair of the works. In the light of this statement, the purchaser should determine his training requirements. The contract should clearly determine the training obligations of the contractor (paragraph 23). Issues to be dealt with in the contract will include the categories and numbers of trainees, their qualifications, the procedure for selecting the trainees, and the places at which they are to receive training (paragraphs 24 and 25).

The contractor should be obligated to supply to the purchaser a training programme which the contractor considers to be adequate. The contract should also fix the payment conditions relating to the training. However, for practical reasons, some issues relating to the training programme may need to be settled after the conclusion of the contract (paragraphs 26 to 28).

* * *

A. General remarks

1. The works to be constructed will embody various industrial processes necessary for production by the works. The purchaser will require a knowledge of the use and application of these various processes. The purchaser will also wish to acquire the technical information and skills necessary for the operation,

maintenance and repair of the works. The communication to the purchaser of this knowledge, information and skills is often referred to as the transfer of technology.

2. It may be noted that different contractual arrangements can be entered into for the construction of the works and the transfer of technology (see chapter II, "Choice of contract type"). The purchaser may select a contractor who is able to supply the technology to be embodied in the works, as well as to construct the works. The purchaser will then usually enter into one works contract with that contractor, which will provide for the transfer of the technology and for the construction of the works. It is also possible for the purchaser to enter into a works contract under which the contractor supplies the technology and constructs that portion of the works which is to embody the technology, and to enter into other contracts with other contractors for the construction of other portions. The purchaser may also enter into one contract for the supply of technology and into a separate works contract for the construction of the works embodying that technology.

3. The transfer of technology may occur in different ways. In many cases a purchaser will acquire a knowledge of the various industrial processes used in the works through acquiring an understanding of the working of the machinery and equipment installed in the works and of the functioning of the works.

4. The transfer of technology may also occur through the licensing of patents or other forms of industrial property. Most legal systems provide for the registration, subject to certain conditions, of industrial processes which are upon registration recognized and protected as industrial property in the country in which the registration takes place. A common form of industrial property consists of patents, although other forms of industrial property may also be recognized and protected. The owner of the industrial property obtains the exclusive right to exploit the processes which are the subject of the industrial property. A contractor who has registered industrial processes as patents may, however, license the patents to the purchaser (i.e. permit the purchaser, subject to the conditions of the licence, to use the processes in the works in return for a royalty). The product resulting from the working of the patent may carry a trademark, and a licensing of the trademark will often accompany the licensing of the patent.

5. The contractor, however, may not have wished, or may have been unable, to protect the industrial processes through registration in accordance with the law relating to industrial property. He may, instead, keep this knowledge confidential. In such cases, the transfer of technology may occur through the communication of this knowledge (generally called know-how) to the purchaser. Such communication is usually subject to conditions as to the maintenance of confidentiality by the purchaser (see paras. 18 and 19, below).

6. The information and skills necessary for the operation, maintenance and repair of the works may be

communicated by the contractor through documents, e.g. operating manuals (see paras. 21 and 22, below). They may also be communicated through the training of the personnel of the purchaser. It may be noted that the different ways in which technology is transferred, referred to in this and the three previous paragraphs, may be combined.

7. The Guide does not attempt to deal comprehensively with contract negotiation and drafting relating to the licensing of industrial property, or the communication of know-how, as this subject has already been dealt with in detail in publications issued by certain United Nations bodies.¹ This chapter merely notes certain major issues which the parties should address when a works contract contains provisions relating to the licensing of industrial property or the communication of know-how.

8. In drafting their contract provisions relating to the transfer of technology, the parties should take account of legislation mandatorily regulating such transfer which may be in force in the purchaser's and the contractor's countries.² Under some legislation, contracts involving the transfer of technology have to be registered with a governmental institution and require its approval. Legislation in some countries may prohibit or restrict the transfer of certain kinds of technology. Legislation may also require each element of the technology to be separately priced, or it may regulate the extent of the price payable or the manner of payment (e.g. the manner in which royalties may be calculated). Tax legislation may also affect the drafting of the contract (e.g. by requiring the parties to determine which party is responsible for the payment of tax on income arising from the transfer of technology).

B. Issues common both to licensing and to know-how provisions

1. Description of technology

9. The parties should carefully describe the technology which is to be transferred.³ Such description may be by reference to documents reflecting the technology (e.g. the patent documents). A precise and comprehensive description may in particular be important when the separate contracts approach is used and contractors

other than the one supplying the technology are to prepare designs or manufacture equipment and machinery to enable the technology to be used in the works.

2. Conditions restricting purchaser in use of technology

10. The contractor may sometimes seek to impose certain restrictions on the purchaser's use of the technology, or the products or outputs produced using the technology. Some of these restrictions are mandatorily regulated under many legal systems, and the parties should take into account the laws of the country of each party before agreeing on such restrictions. The extent to which such restrictions may be permissible in the contract are being negotiated at the sessions of the United Nations Conference on an International Code of Conduct on the Transfer of Technology.

3. Guarantees⁴

11. The guarantees to be given by the contractor in regard to technology supplied by him may depend on the nature of the contractual arrangements. If the contractor, in addition to supplying the technology, also supplies the design for the plant which is to use the technology, and the machinery and equipment for the plant, he may be required to guarantee that the works will operate in accordance with specified parameters. The type of parameters used (e.g. product quality, production capacity, utilities consumption, catalyst consumption, or quantity of effluent) will depend on the nature of the works.

12. In some cases, however, contractual arrangements are adopted whereby the contractor supplies the technology, part of the design, and some of the machinery and equipment necessary for the utilization of the technology, while other contractors supply the rest of the design and other machinery and equipment. In such cases, the contractor may be unwilling to give without qualifications a guarantee of performance similar to that noted in the previous paragraph. He may in such cases be required to give a guarantee that the use of the technology will result in the operation of the works in accordance with certain specified parameters, provided the technology is utilized and the works is constructed in accordance with conditions specified by the contractor (e.g. use of certain construction methods, standards, components and raw materials; use of a certain design for layout of the works; provision of certain operating conditions, such as the temperature in certain areas of the works). If the contractor is supplying the technology and constructing the major portion of the works, he may be prepared to accept a different approach under which he gives a guarantee that the works will operate in accordance with the parameters specified in the

¹The drafting of agreements for the licensing of industrial property and the communication of know-how is dealt with in detail in *Licensing Guide for Developing Countries* (Geneva, WIPO, 1977) (hereinafter referred to as the WIPO Guide). The main issues to be considered in drafting such contracts are set forth in *Guidelines for Evaluation of Transfer of Technology Agreements* (ID/233) (hereinafter referred to as the UNIDO Guidelines) and in *Guide for Use in Drawing up Contracts relating to the International Transfer of Know-how in the Engineering Industry* (ECE publication No. TRADE/222/Rev.1) United Nations publication, Sales No. E.70.E.15. Another relevant publication is the *Handbook on the Acquisition of Technology by Developing Countries* (UNCTAD/TT/AS/5) (United Nations publication, Sales No. E.78.II.D.15).

²See WIPO Guide, part II, section U, "Approval of government authorities", and section O, 7, "Taxation".

³See WIPO Guide, part II, section D, 1, "Identification and description of the basic technology".

⁴See WIPO Guide, part II, section G, 4, "Guarantee of know-how", and UNIDO Guidelines, chapter III, "Performance of know-how—licensor's guarantee obligations". Issues relating to defects covered by a guarantee, the guarantee period, and a manufacturer's guarantee are dealt with in the chapter "Failure to perform".

contract (see preceding paragraph). However, if the works fails to operate in accordance with such parameters, the contractor may be permitted to avoid liability if he proves that the failure to operate was due to a failure of performance by another party involved in the construction.

4. *Price⁵*

13. Commercial practice has evolved distinct methods for determining the price payable for a licence of industrial property or the communication of know-how. In relation to such transactions, the price is usually determined as a lump-sum, or in the form of royalties. The unit-price method (see the chapter "Price") is unsuitable, as no units are supplied. When the contractor obtains the technology from a third party, the parties may in some cases wish to adopt the cost-reimbursable method (see the chapter "Price") and to provide that the costs incurred in obtaining the technology are to be reimbursed by the purchaser, provided that they do not exceed a specified limit.

14. If the lump-sum method is used, the total price is determined at the time of the conclusion of the contract, and this price is payable in one or more instalments. If the royalty method is used, the price payable (i.e. the royalty) is fixed by reference to some economic result of the use of the transferred technology. For example, the royalty is often fixed by reference to the production, sales, or profits arising from the use of the technology. Where the volume of production is used as the reference factor, the royalty may be determined, for instance, as a fixed amount per unit or quantity (e.g. per ton or per litre) produced. Where the volume of sales is used as the reference factor, the royalty may be determined as a percentage of the sales price. Under each method, what is meant by production, sales price, or profits will need careful definition.

15. Each method of price calculation may have certain advantages and disadvantages,⁶ depending on the economic circumstances attending the contract. The two methods may also be combined (e.g. an initial lump-sum payment followed by the payment of royalties).

5. *Infringement of rights of third party⁷*

16. The parties may wish to include in their contract an undertaking by the contractor that the industrial property or know-how transferred does not infringe the industrial property rights of a third party. They may also wish to include an undertaking by the purchaser that, where the contractor has to manufacture machinery

or equipment in accordance with designs supplied by the purchaser, such manufacture will not infringe the industrial property rights of a third party. They should also provide for the remedies which the purchaser or contractor may have in the event that a third party brings an action against one of them claiming infringement.

17. Each party should be obligated to notify the other of any claim for infringement immediately after he learns of such a claim. The contractor may be obligated to modify the technical processes supplied by him so that the third party's rights are no longer infringed, provided that such modification does not adversely affect the capability of the works to operate in accordance with the contract, and that the contractor bears the costs of the modification. The purchaser may be obligated to modify the design supplied by him so that the third party's rights are no longer infringed, and to bear the costs incurred by the contractor as a result of such modification of design. If legal proceedings are brought against a party, the other party should be obligated to assist him in defending those proceedings. If as a result of the legal proceedings the technology supplied by the contractor cannot be used in the works, or the works cannot be operated so as to achieve the performance parameters specified in the contract, the purchaser should have the remedies usually available upon a failure of performance by the contractor (see chapter XXX, "Failure to perform").

C. *Issues special to know-how provisions*

Confidentiality⁸

18. The contractor will usually require the know-how disclosed by him to be kept confidential (see para. 5, above). He may require such confidentiality at two stages. Firstly, he may disclose some know-how to the purchaser during negotiations, to enable the purchaser to decide whether he wishes to enter into a contract, and to make proposals as to contract terms. He will wish the purchaser to keep this know-how confidential. Secondly, if a contract is concluded, the contractor will require the additional know-how disclosed thereafter to be kept confidential. In such cases the parties should agree upon contractual provisions obligating the purchaser to maintain confidentiality.

19. The extent to which obligations as to confidentiality can be imposed on the purchaser may be regulated by mandatory legal rules in the purchaser's country. Issues to be addressed by such contractual provisions on confidentiality may include clear identification of the know-how to be kept confidential, the duration of the confidentiality (e.g. a fixed period) and the extent of permissible disclosure (e.g. disclosure

⁵See WIPO Guide, part II, section N, "Compensation; consideration; price; remuneration; royalties; fees", and UNIDO Guidelines, chapter VII, "Remuneration".

⁶These are considered in detail in the WIPO Guide, part II, section N, referred to in the preceding footnote.

⁷See WIPO Guide, part II, section E, "Special aspects concerning patents", and section S, 2, d. "Warranty against third parties for infringement".

⁸See WIPO Guide, section G, 2, "Legal means for preventing communication, disclosure or use of valuable information and expertise". In addition to confidentiality in respect of know-how, the contractor may require confidentiality in respect of documents describing the scope and quality of the works. This is dealt with in the chapter "Scope and quality of works".

being permissible in specified circumstances, or to specified persons). The parties may wish to provide that once the know-how to be kept confidential reaches the public domain, the obligation of confidentiality is to cease. The parties may also wish to provide, for example, that an engineer employed by the purchaser to supervise the construction should be allowed access to such of the know-how as is necessary for him to exercise effective supervision. They may further wish to provide that if the contract is terminated by the purchaser because of a failure of performance by the contractor, the purchaser may disclose to another contractor such of the know-how as is necessary for completion of construction by the other contractor. If the contract is terminated because the contractor is prevented by an exempting impediment from completing the construction (e.g. regulations in the contractor's country prevent him from exporting certain equipment), and the purchaser wishes to complete the construction by engaging another contractor, it may be provided that such of the know-how as is necessary for completion of construction may be disclosed to the other contractor.

D. *Communication of technical information and skills*

20. The purchaser will usually wish to be provided by the contractor with the technical information and skills necessary for the proper operation, maintenance and repair of the works. Such information and skills are normally conveyed through the supply of technical documentation and through the training of personnel.

1. *Supply of documentation*

21. The documentation to be supplied may consist of plans, drawings, formulae, manuals of operation and maintenance, and safety instructions. It may be advisable to list in the contract the documents to be supplied. The contractor may be obligated to supply documents which are comprehensive and clearly drafted, and the language of the documents may be specified. If procedures described in the documentation cannot be understood without demonstrations, the contract should obligate the contractor, at the request of the purchaser, to give such demonstrations.

22. The points of time at which the documentation is to be supplied may be specified. The supply of all documentation should be completed by the time fixed in the contract for completion of construction, and the parties may wish to provide that construction is not to be considered as completed unless all documentation relating to the operation of the works has been supplied. It may be advisable to provide that some documentation (e.g. operating manuals) is to be supplied in the course of construction, as such documentation may enable the purchaser's personnel or engineer to obtain an understanding of the working of machinery or equipment while it is being erected. It may also be advisable to provide that the contractor is liable to pay damages for loss caused to the purchaser through any errors or omissions in the documentation.

2. *Training of personnel*

23. In order to enable him to decide on his training requirements, the purchaser may wish in the invitation to tender or during the contract negotiations to request the contractor to supply him with a statement of the personnel requirements for the operation, maintenance and repair of the works, including the basic technical and other qualifications which the personnel must possess. This statement of requirements should be sufficiently detailed to enable the purchaser to determine the extent of training that he may require the contractor to provide. The parties should thereafter in the contract fix, to the extent possible, the training obligations of the contractor. A time schedule for training should be agreed, which is harmonized with the time schedule for construction. The parties should determine the times at which training is to be given, and provide that the training is to be completed by the time agreed for the completion of construction.

24. The contract should fix the categories of employees in respect of which training is to be given (e.g. chief mechanical engineer, electrical engineer) and the numbers to be trained. The contract should also fix the qualifications which trainees for a particular post must possess (e.g. educational background, linguistic abilities, technical skills, work experience). If these qualifications are not agreed in the contract, the contractor may have grounds for attributing the failure of the training to lack of relevant qualifications. The parties may also wish to provide that the selection of trainees is to be done jointly by the parties.

25. Training will often be required both on site and at places abroad. The places at which training is to be given abroad should be specified. While these would normally be at the contractor's works, in some cases the appropriate training might only be available at works or factories of third parties (e.g. technology or equipment suppliers). In such cases, the contractor should undertake to obtain placement of the trainees at such places. It may be advisable to provide that the operational conditions at the places of training are to be similar to those which the trainees will later encounter in the works.

26. The training obligations of the contractor in relation to each category of trainee should be clearly defined. In this connection, the contract should obligate the contractor to supply to the purchaser a training programme which he considers will enable the trainees to obtain the information and skills necessary for the proper discharge of their duties in the operation, maintenance and repair of the works. The programme should describe the nature of the training to be given. The contract may provide that this programme is to be approved by an engineer engaged by the purchaser. The contract should also obligate the contractor to engage trainers with qualifications and experience appropriate for the training. The purchaser should be notified before the commencement of training of such qualifications and experience. Where the parties enter into a product-in-hand contract (see chapter II, "Choice of

contract type"), the contractor is obligated to prove during a test period that the works can be successfully operated by the purchaser's staff. This obligation would influence the nature of the training programme needed.

27. The training of the personnel of the purchaser which is necessary may be minimal, e.g. making them acquainted on site with the procedures for operating and maintaining the plant. The parties may wish to agree that no price is to be paid for such training, as it is ancillary to the obligations of the contractor to supply and construct the works. Where more extensive training is required, it may be convenient to specify separately the price for the training. The price may be payable in stages (e.g. a percentage as an advance payment, a further percentage during the performance of the training programme, and the balance after proof of completion of the programme). The training programme may involve other costs (e.g. the living expenses of the trainees in the contractor's country, or the living expenses of the contractor's trainers in the purchaser's country), and the allocation of these should be settled. The contract may provide that the portion of the price for the training which covers costs incurred in the purchaser's country should be paid in the currency of that country.

28. For practical reasons, it may not be possible to settle some issues which arise in regard to training at the time of the conclusion of the contract (e.g. the date for commencement of training, or the duration of training). The parties should agree that such issues should be settled by the parties within a specified period of time after the conclusion of the contract.

[A/CN.9/WG.V/WP.15/Add.4]

Transfer of ownership of property

Summary

The issue of whether the contractor or the purchaser owns certain types of property involved in a works contract may be important in connection with certain questions (e.g. insurance and taxation). The transfer of ownership of property from one party to the other is usually governed by the law where the property is situated, and many legal rules governing this issue have a mandatory character. The parties have, therefore, only a limited scope to deal with this issue in the contract. The parties may be satisfied with the rules of the applicable law governing this issue, and accordingly may not wish to address it in the contract (paragraphs 1 and 2).

In drafting contract provisions in regard to the transfer of ownership of equipment and materials supplied by the contractor for incorporation in the plant, the parties should note that after incorporation in the plant such equipment and materials may cease to

be objects of independent ownership. The parties may wish to select a point of time for the passing of ownership such that the equipment and materials do not remain in the ownership of the contractor after the purchaser has paid a substantial portion of the price for them (paragraphs 3 and 4).

In regard to the transfer of ownership of equipment and materials supplied by the purchaser for incorporation in the plant, the purchaser should retain the ownership in such equipment and materials in cases where the plant during construction is owned by the purchaser. The parties should seek to avoid multiple transfers and re-transfers of ownership (paragraph 5).

In regard to the transfer of ownership of the plant during construction and the works after completion, in general the law of the country where the works is to be constructed will apply and will often provide that the plant and the works will be owned by the owner of the site, normally the purchaser (paragraph 6). If the law of the site permits the ownership of the plant and the works to be independent of that of the land, various considerations may be relevant to determining an appropriate allocation of ownership. For example, if a substantial portion of the price is to be paid by the purchaser in the form of progress payments during construction, the contract may provide that the purchaser is to own the plant (paragraph 7). The contractor might seek to obtain an allocation of the ownership to him in order to safeguard himself against the bankruptcy of the purchaser, or the seizure of the purchaser's property by his creditors, during construction. Where such an allocation is made, the contract may provide that ownership is to pass to the purchaser upon take-over (paragraph 8). The contractor might seek to obtain even greater protection through retention of ownership of the plant and the works till the entire price is paid. This may be justifiable to secure a credit given by the contractor to the purchaser in respect of the price (paragraph 9).

* * *

A. General remarks

1. The issue of whether the contractor or the purchaser owns certain types of property involved in a works contract may be important in connection with questions of insurance, taxation and liability to third persons arising from the property or its use (e.g. for loss or damage caused by such property). Whether the property is owned by one party or the other is also important because property is subject to seizure by creditors of its owner and is subject to bankruptcy proceedings against him.¹

¹It should be noted that the incidence of the ownership of the property should not be relevant to the question of which party is to bear the risk of loss of or damage to it (see the chapter "Allocation of the risk of loss or damage"). Furthermore, the passing of ownership of property to the purchaser should not imply approval by the purchaser of the quality of such property.

2. Some works contracts contain provisions dealing with the time when ownership of equipment and materials to be incorporated in the works, of the plant during construction and of the works after its completion, passes from the contractor to the purchaser. However, the transfer of ownership of such property is usually governed by mandatory rules of the legal system where the property is situated, which often give the parties only limited scope to determine in the contract the time when ownership passes from one party to the other. While under most legal systems ownership of property may not pass till the property is identified to the contract, some legal systems require in addition that the property be handed over to the party who is to acquire the ownership. Furthermore, many legal systems require that certain formalities be satisfied for the transfer of ownership of immovable property, in particular to give effect to the transfer as against third parties. In some cases, the parties may be satisfied with the rules of the applicable legal system determining when the transfer of ownership occurs and will not wish to include in their contract provisions regulating the transfer of ownership of property.

B. *Transfer of ownership of equipment and materials supplied by contractor for incorporation in plant*

3. In some cases, the parties might consider it desirable for the contract to specify the time when ownership of equipment and materials supplied by the contractor for incorporation in the plant passes to the purchaser. In drafting such provisions, the parties should take account of the fact that after incorporation of the equipment and materials in the plant, such equipment and materials may become merged in the plant and under many legal systems may cease to be objects of independent ownership.

4. In cases where equipment or materials are to be incorporated in the plant which is owned by the purchaser, the parties may wish to select a point of time for the passing of ownership such that the equipment and materials do not remain in the ownership of the contractor after the purchaser has paid a substantial portion of the price for them. The purchaser may otherwise suffer serious loss if the property of the contractor is seized by his creditors, or if the contractor is declared bankrupt. The contract may provide that, after such payment has been made by the purchaser, ownership is to pass from the contractor to the purchaser, for example, when the equipment and materials are handed over to the first carrier for transport to the purchaser, or when the equipment and materials are delivered to the site. If a substantial portion of the price for equipment has been paid during the manufacture of the equipment, the contract should provide that the transfer of ownership of such equipment occurs at the time of such payment, provided the equipment can be identified to the contract.

C. *Transfer of ownership of equipment and materials supplied by purchaser*

5. In cases where the plant during construction is owned by the purchaser, it is desirable for the purchaser to retain the ownership of equipment and materials supplied by him for incorporation in the plant by the contractor. In the exceptional cases where the plant during construction is owned by the contractor, the purchaser may wish to retain the ownership of such equipment and materials until they are incorporated in the plant, unless they have been previously paid for by the contractor. The parties, however, should seek to avoid multiple transfers and re-transfers of property to the greatest extent possible.

D. *Transfer of ownership of plant during construction and works after completion*

6. Under some legal systems, all things affixed to land are considered to be within the ownership of the landowner. If this principle applies under the law of the country where the works is to be constructed, the plant during construction and the works after its completion will be owned by the owner of the site, who is normally the purchaser.

7. If the law of the site permits ownership of the plant and the works to be independent of that of the land, the parties may consider whether they are content to rely on the law of the site of the plant and the works for the allocation of ownership to the purchaser or the contractor, or whether they wish to provide for such allocation in the contract. If they choose to provide for such allocation in the contract, various considerations may be relevant to determining an appropriate allocation of ownership. For example, if a substantial portion of the price is to be paid by the purchaser in the form of progress payments during construction, the contract may provide that the plant should be owned by him from the commencement of construction. Moreover, in some cases ownership by one contractor may not be practicable or permitted under the law of the site, for example where several contractors participate in the construction and it is not practicable or permitted for each contractor to own the portion of the plant constructed by him. In such cases the plant should be owned by the purchaser.

8. If allocation of the ownership of the plant and the works to the contractor is permissible under the law of the site, the contractor might seek to secure such an allocation in order to safeguard himself against the bankruptcy of the purchaser, or the seizure of the purchaser's property by his creditors, during construction. He may in particular wish to secure such an allocation when the payment conditions provide that the major portion of the price is to be paid on a date after the completion of the works. Where the contract provides for such an allocation of ownership to the contractor, the contract may also provide that ownership is to pass to the purchaser upon take-over of the works by him.

9. The contractor might seek to obtain even greater protection through contract provisions which entitle him to retain the ownership of the plant and the works until the entire price is paid. Such protection of the contractor may be justifiable if it is intended to secure credit given by the contractor to the purchaser in respect of the price, a substantial portion of which is to be paid on a date after the expiration of the guarantee period. The law of the site, however, may require that an arrangement for the retention of ownership must comply with certain formalities.

the contractual relationship which are to be governed by the chosen law (paragraph 13).

In addition to the law applicable to the contract by virtue of the rules of private international law, mandatory rules of a public nature which are in force, in particular in the countries of the purchaser and contractor, may govern certain aspects of the construction (paragraphs 3 and 14). Such mandatory rules may concern technical aspects of the works or its construction (paragraphs 15 to 18), export, import and foreign exchange restrictions (paragraphs 19 and 20) and customs duties and taxes (paragraph 21).

[A/CN.9/WG.V/WP.15/Add.5]

Applicable law

Summary

The rules of one or more legal systems may be applicable to a works contract, and govern, among other things, the formation and validity of the contract, and the interpretation and application of contractual provisions relating to the rights and obligations of the parties (paragraph 1). The determination of the law applicable to the contract is governed by the rules of private international law. These rules, however, give the parties considerable freedom to choose the law applicable to the contract (paragraphs 2, 5 and 7).

In the absence of a choice by the parties, uncertainty as to the law applicable to the contract may arise from two factors. Firstly, it may be unclear which rules of private international law will determine the law applicable to the contract. Secondly, even if this is clear, the rules of private international law may sometimes be too imprecise to enable the law applicable to the contract to be ascertained with reasonable certainty (paragraph 6).

It is desirable for the parties to specify that they are choosing only the substantive rules of a legal system to constitute the law applicable to the contract, and are excluding the application to the contract of the rules of private international law of the legal system (paragraph 8). The choice by the parties of the law applicable to the contract relates only to the legal rules governing their mutual contractual rights and obligations, and will usually not directly affect the rights and duties of persons who are not parties to the contract (paragraph 9).

The law of the purchaser's country is often chosen as the law applicable to the contract; however, the parties might wish to consider choosing the law of the contractor's country, or the law of a third country (paragraphs 10 and 11).

It is advisable to choose a single legal system to be the law applicable to the contract (paragraph 12). In addition to providing that the chosen law governs the contract, it may be desirable to identify the aspects of

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A. General remarks

1. The legal rules of one or more legal systems will be applicable to a works contract. Such legal rules will govern, among other things, the formation and validity of the contract and the interpretation and application of contractual provisions relating to the rights and obligations of the parties. Moreover, the parties may either intentionally or unintentionally leave some issues concerning their contractual relationship unsettled in the contract, and for the settlement of such issues reference will have to be made to the relevant legal rules of some legal system. The legal rules which govern the mutual contractual rights and obligations of the parties are referred to in this Guide as the "law applicable to the contract".

2. The parties may exercise a certain degree of control over the law applicable to the contract, first by agreeing upon a legal system containing legal rules which are to constitute the law applicable to the contract, and second by modifying or excluding certain of those legal rules, if they are not mandatory.

3. In addition to the law applicable to the contract, particular aspects of the performance of the contract may be affected by laws in force in the countries of the parties and the country where the works is being constructed (if different from the country of the purchaser) which seek to regulate certain matters in the public interest (see paras. 15 to 21, below). Such laws may concern, for example, safety standards to be observed in construction, protection of the environment, import, export and foreign exchange restrictions, and customs duties and taxes. Normally, the parties will not be able to control the application of such legal rules.

4. Finally, the parties might wish to note that the rules of the legal systems of the places where equipment or materials are situated from time to time, or where the plant or the works is situated, may govern the transfer of ownership of such property, regardless of the choice by the parties of the law applicable to the contract (see the chapter "Transfer of ownership of property"). The question of which legal system's procedural rules are to govern legal proceedings for the settlement of disputes

arising from the contract is discussed in the chapter "Settlement of disputes".

B. *Choice of law applicable to contract*

5. Since an international works contract has points of contact with more than one country, there will be more than one legal system the rules of which could potentially be regarded as the appropriate rules to constitute the law applicable to the contract. The determination of the law applicable to the contract is governed by rules of private international law. The rules of private international law in most legal systems give the parties considerable freedom to choose for themselves the law applicable to the contract (see para. 7, below).

6. It is desirable for the parties to stipulate in the contract itself the legal system containing the legal rules which are to constitute the law applicable to the contract. If the parties do not do so, the law applicable to the contract may be uncertain. Such uncertainty arises from two factors. First, the rules of private international law by which the law applicable to the contract will be determined vary from country to country. If disputes under the contract are to be submitted to arbitration, it may be uncertain which rules of private international law the arbitrators will apply to determine the law applicable to the contract. If the contract does not specify a country where judicial proceedings to settle disputes under the contract must be instituted (see the chapter "Settlement of disputes"), it may be possible to institute proceedings in the courts of more than one country. Since each court will apply the rules of private international law of its own country, there may be several possible systems of private international law which could govern the determination of the law applicable to the contract. Even if the contract does stipulate the country where judicial proceedings must be instituted, such a stipulation may, under certain circumstances, be held invalid in some legal systems (see the chapter "Settlement of disputes"). The second factor producing uncertainty as to the law applicable to the contract is that, even when it is known which rules of private international law are to determine the law applicable to the contract, these rules are sometimes too imprecise to enable such law to be ascertained with reasonable certainty.

7. The extent to which the parties are allowed to choose the law applicable to the contract will be determined by the rules of private international law applied by a court or arbitral tribunal which is called upon to decide a dispute between the parties. Under many systems of private international law, the parties are permitted to choose the law applicable to the contract without any restrictions. Under other systems, however, the autonomy of the parties is limited (e.g. they are only permitted to choose a legal system which has some connection with the contract, such as the legal system of the country of one of the parties or of the place of performance). Accordingly, the parties should

take care to make a choice which will be upheld by such rules.¹

8. It is desirable for the parties specifically to provide in a choice-of-law clause that they are choosing only the substantive rules of the chosen legal system to govern their contractual relationship, and that they are excluding the application of the rules of private international law of that system. This will avoid the application, by virtue of the rules of private international law of the chosen system relating to remission (*renvoi*) or transmission, of the substantive legal rules of a legal system other than that chosen by the parties.

9. The choice by the parties of the law applicable to the contract relates only to the legal rules governing their mutual contractual rights and obligations; such a choice will usually not directly affect the rights and duties of persons who are not parties to the works contract (e.g. sub-contractors, personnel employed by the contractor or the purchaser, or the creditors of a party).

10. In many cases the parties may wish to choose as the law applicable to the contract the law of the country where the works is to be constructed, or the law of the purchaser's country, if this is different from the country where the works is to be constructed. This approach is often used in cases where tendering is required by the purchaser, since otherwise different tenders specifying different legal systems to apply to contracts concluded as a result of such tenders would not be comparable. In some works contracts, the parties may wish to choose the law of the contractor's country. In other contracts, the parties may prefer to choose the law of a third country which is known to both parties and which deals in an appropriate manner with the legal issues arising from the contract. If the contract stipulates that the courts of a particular country are to have exclusive jurisdiction over judicial proceedings to resolve disputes arising from the contract, the parties may wish to choose the law of that country. This could expedite judicial proceedings and make them less expensive, since a court would have little difficulty in ascertaining and applying the law of its own country. If a country has several legal systems, as in a federal State, it would

¹The parties may wish to note that the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) may apply to some works contracts if the parties have their places of business in different States and these States are parties to the Convention, or when the rules of private international law lead to the application of the law of a Contracting State, in particular when the parties choose the law of a Contracting State. Article 3 of the Convention provides that contracts for the supply of goods to be manufactured or produced are to be considered sales contracts, subject to two exceptions. If the law of a State party to the Convention is to be chosen as the law applicable to the contract, the parties may wish to indicate whether or not they intend the Convention to be applicable. The Convention is flexible enough to allow the parties to modify its rules or exclude its application entirely as the needs of the parties may require (see United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), articles 1, 3 and 6 (A/CONF.97/18)).

be advisable for the parties in making their choice to indicate the particular legal system the legal rules of which are to constitute the law applicable to the contract.

11. The parties may also wish to take the following factors into consideration in deciding upon the law applicable to the contract:

(a) The parties' knowledge of, or possibility of gaining knowledge of, the law;

(b) The capability of the law to settle in an appropriate manner the legal issues arising from the contract;

(c) The extent to which the law may contain mandatory rules which would prevent the parties from settling in the contract and in accordance with their needs issues arising from the contract.

12. It is advisable for the parties to choose a single legal system the rules of which are to constitute the law applicable to the contract, and for these rules to govern all rights and obligations arising in connection with their contractual relationship. Under the rules of private international law of some legal systems, the parties are permitted to provide that the legal rules of different legal systems are to apply to different rights and obligations under the contract. However, if the parties adopt this approach, difficulties may arise, since the legal rules of the different legal systems may not be in harmony, and some gaps or inconsistencies in the applicable rules may result.

13. The choice-of-law clause should provide that the contract is to be governed by the chosen law. In addition, it may be desirable for the clause to identify some of the aspects of the contractual relationship between the parties which are to be governed by the chosen law. If the parties do not adopt this course, the courts in some legal systems might interpret the clause as not applying the chosen law to certain rights or duties which the parties intended to be governed by the chosen law (for example, as applying to rights and obligations arising from the contract, but not to rights and obligations arising from a breach of contract). Accordingly, it may be desirable for the contract to provide that the chosen law is to govern, for example, the formation of the contract, the validity of the contract and the legal consequences if it is invalid, the interpretation of the contract, the rights and obligations of the parties arising from the contract, the time of passing of the risk of loss or damage, the consequences of a failure to perform and the variation, suspension and extinction of contractual rights and obligations. Under the rules of private international law of some countries, a chosen law may govern the prescription of claims, while under the rules of private international law of other countries rules relating to prescription (limitation of actions) are of a procedural character and cannot be governed by the chosen law; rather, the

procedural rules of the place where the legal proceedings are brought will apply.²

C. *Mandatory legal rules of public nature*

14. In addition to legal rules applicable by virtue of the rules of private international law, certain rules of an administrative or other public nature in force in the countries of the parties or other countries (e.g. in the country where the works is being constructed) will govern certain aspects of the construction. These rules are often mandatory and therefore must be observed even if they are not reflected in the contract, irrespective of the identity of the legal system whose rules constitute the law applicable to the contract.

1. *Rules concerning technical aspects of works or its construction*

15. In the country where the works is to be constructed, there usually exist certain mandatory rules concerning technical aspects of the works or its construction. Such rules often relate, for example, to safety requirements during the construction and operation of the works, environmental protection, and health and labour conditions. In addition to these rules imposed by the country where the works is to be constructed, safety standards for equipment may be imposed by the country where such equipment is produced.

16. It is desirable for the legal rules described in the previous paragraph to be incorporated in some manner into the contract, e.g. in provisions regarding the scope and quality of the works. Since it may be difficult for the contract expressly to reflect all the relevant legal rules concerning technical aspects of the works, it may be desirable for the contract to contain a provision obligating the contractor to construct the works in conformity with all applicable rules concerning safety, environmental protection, and health and labour conditions. The purchaser may, however, be obligated to assist the contractor with information about the existence and scope of such rules.

17. It is also desirable to settle in the contract which party is to bear the risk of a change in the mandatory rules concerning technical aspects of the works or its construction, or of the creation of new rules, after the conclusion of the contract. Usually the construction can

Illustrative provision

"The law of ... (country), excluding its rules of private international law, shall govern this contract. Without limiting the generality of the foregoing, this law shall govern the following issues: the formation of the contract, the validity of the contract and the legal consequences if it is invalid, the interpretation of the contract, the rights and obligations of the parties arising from the contract, the time of passing of the risk of loss or damage, the failure to perform and its consequences, [the prescription of claims,] and the variation, suspension or extinction of contractual rights and duties."

continue despite the changed or new rules, and the parties may wish to obligate the contractor to construct the works in accordance with the changed or new rules. If this approach is adopted, the parties might also wish to consider whether a change in the costs of construction resulting from the changed or new rules should result in an adjustment of the price (see the chapter "Price"). In the exceptional circumstances in which it becomes impossible to continue with the construction because of the changed or new rules, termination of the contract might be justified (see the chapter "Termination").

18. It is desirable for the contract to obligate the purchaser to obtain official approvals or authorizations, required under the law of the country where the works is to be constructed, for the use of the site for construction and for the operation of the works. The contractor may be obligated to assist the purchaser in this respect, in particular by providing all relevant technical data concerning the construction to be effected by the contract and concerning the operation of the works.

2. *Rules concerning export, import and foreign exchange restrictions*

19. In the country where the works is to be constructed, there may exist rules which restrict the import of equipment or materials to be used for construction, or the supply of services or the transfer of technology by foreign suppliers. In some cases there may also exist in the contractor's country rules which restrict the export of equipment or materials, the supply of services or the transfer of technology to foreign parties. In addition, foreign exchange or currency rules in the purchaser's country may affect the payment of the contract price by the purchaser. It is desirable for all such rules to be taken into consideration in drafting the contract in order to avoid having the contract or some of its provisions held to be invalid. If such rules are issued only after the conclusion of the contract, their application may result in a legal impossibility to perform the contract. The law applicable to the contract or the contract itself may determine the effects of such situations. In some cases they might justify termination of the contract (see the chapter "Termination"). Whether damages may be claimed in such circumstances and, if so, under what conditions, is discussed in the chapter "Exemptions".

20. It is desirable for the contract to obligate the contractor to obtain export and other licences needed for his performance which are required under the law of his country, while the purchaser might be obligated to obtain import and other licences needed for the performance by the contractor which are required in the country where the works is to be constructed, as well as licences or approvals required for payment of the price.

3. *Rules concerning customs duties and taxes*

21. While legal rules concerning customs duties or taxes may not affect the technical aspects of the works or its construction, or prevent the completion of the works in accordance with the contract, they could have important effects in respect of financial aspects of the construction. Contractual provisions concerning taxes and customs duties are discussed in the chapter "Customs duties and taxes".

[A/CN.9/WG.V/WP.15/Add.6]

Construction on site

Summary

Construction on site covers erection of equipment, building and civil engineering. Under a works contract, the supplier of equipment may himself effect such construction, or he may supervise construction by the purchaser or another person engaged by the purchaser (paragraph 1).

The contract should allocate responsibilities with respect to the work to be performed in preparation for construction. This may include such matters as clearing and levelling the site (the site will normally be provided by the purchaser), providing access roads or railways, making available water and energy, providing accommodation, utilities and other facilities needed for the purposes of the construction by the contractor's personnel, assisting in obtaining visas and work permits for the contractor's personnel, and providing a workshop (paragraphs 2 to 6).

The contract should normally stipulate that the contractor is responsible for providing all construction machinery and tools needed for effecting the construction undertaken by him. In cases where some of such items are to be supplied by the purchaser, the contract should specify the rights and obligations of the parties in respect of such items. The contract should also allocate responsibilities in respect of obtaining licences and authorizations required for the import by the contractor of construction machinery and tools which he intends to re-export after the completion of the construction, and in respect of transport needed for effecting the construction (paragraphs 7 to 9).

The contract should set forth the time when the construction is to be completed (paragraphs 10 to 14). It should contain a time schedule to establish the sequential order in which the construction is to take place. The time schedule may establish obligatory milestone dates for achieving progress in the course of construction, and the contractor should be liable for delay if he fails to meet such milestone dates. In cases where it is not possible to agree upon all the details of the time schedule at the time of the conclusion of the

contract, the purchaser may be authorized to determine the time schedule by notifying it to the contractor within a specified period of time before the commencement of construction (paragraphs 15 to 19).

The contract should stipulate the situations in which the time for completion, or an obligatory time for construction of a portion of the works under a time schedule, is to be extended, and provide a mechanism for effecting such an extension (paragraphs 20 to 22).

If the separate contracts or the semi-turnkey contracts approach is used, in addition to supplying equipment to be incorporated in the works, a separate or semi-turnkey contractor may assume the obligation to supervise construction to be effected either by the purchaser's personnel or by a local contractor engaged by the purchaser. When the contractor is to supervise construction to be effected by the purchaser or by persons engaged by him, the contract should specify the responsibilities of the parties in respect of the construction to be supervised. Usually, the contractor should be obligated to give instructions concerning the technical aspects of the construction and to inspect such construction, and the purchaser or persons engaged by him should be obligated to carry out with proper skill and care the instructions given by the contractor. The contractor should not be liable for defects in the construction caused by a failure of the purchaser or persons engaged by him to comply with the contractor's instructions (paragraphs 23 to 26).

The contract should define the rights of access to the site of each party and of third persons, and should establish which party is responsible for excluding persons who have no right of access (paragraphs 27 to 31).

The parties may wish to agree that certain obligations concerning the working conditions of the contractor's personnel on site are to be assumed by the purchaser. The contract should obligate the contractor to comply with mandatory rules of law relating to working conditions, and the purchaser might be obligated to assist the contractor in obtaining information concerning such rules (paragraphs 32 and 33).

The contract should obligate each party to co-operate with the other to the extent needed for the performance of each party's obligations, and to avoid conduct which interferes with such performance. When more than one contractor is to participate in the construction, each contractor should also be obligated to avoid conduct which interferes with the performance of the obligations of other contractors. As a mechanism to promote co-operation between the parties, the contract might provide for each party to appoint a liaison agent to serve as a means of communication between the parties with respect to the day-to-day construction of the works (paragraphs 34 and 35).

The contract should set forth any obligations of the contractor with respect to his procurement on behalf of the purchaser of materials or other items needed for

construction to be effected by the purchaser, as well as any obligations of the contractor to assist the purchaser in contracting with third parties (paragraphs 36 to 39).

The contract should set forth the obligations of the contractor to clear the site periodically during construction and after take-over or acceptance of the works (paragraph 40).

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A. *General remarks*

1. Construction on site, as discussed in this chapter, covers erection of equipment, building and civil engineering. Under a works contract, the supplier of equipment may himself effect such construction, or he may supervise construction effected by the purchaser or another person engaged by the purchaser.

B. *Preparatory work*

2. Under all works contracts, the purchaser is normally obligated to provide a site. The site should be identified in the contract (e.g. by reference to maps or plans). The contractor will normally have inspected the site prior to the conclusion of the contract, and may have assumed some obligations as to the suitability of the site for the proposed construction (see the chapter "Invitation to tender and negotiation process").

3. Some preparatory work on the site is usually needed to enable construction to commence and to progress smoothly. Such preparatory work usually consists of clearing and levelling the site, providing access roads or railways, and making water and energy available to the site. The contract should specify the obligations of each party in regard to such preparatory work, fix a time schedule for such work, and determine which party is to bear the costs of such preparatory work. It may be advisable for the purchaser to undertake some items of preparatory work even when the turnkey contract approach is adopted (see the chapter "Choice of contract type"). It is desirable for the contract to obligate the purchaser to obtain official approvals or authorizations, required under the law of the country where the works is to be constructed, for the use of the site for construction (see the chapter "Applicable law").

4. The contract should determine which party is to provide accommodation, utilities and other facilities needed for the purposes of the construction by the contractor's personnel. It may be convenient for the purchaser to undertake some or all of the following obligations: to provide offices and living quarters suitable for the contractor's personnel; to equip such accommodation with furniture and with telephones and other utilities; to provide food or catering facilities for the contractor's personnel; to provide sanitary facilities on the site; and to provide daily transportation for the contractor's personnel between their living quarters and the site.

5. It may be advisable before commencing construction to hold a joint inspection by the parties of the facilities to be provided by the purchaser, and to describe the condition of such facilities in a protocol signed by both parties. The parties may also wish to provide that the purchaser is to assist in obtaining visas, work permits, and similar documents which are necessary for the contractor's personnel to enter the country of the site or to commence work there.

6. It is usually necessary to provide a workshop for the purposes of the construction, and the contract should obligate the contractor to provide such a workshop. The purchaser may wish to retain this workshop for the purposes of repairing and maintaining the works after construction has been completed. In such cases the contract may treat the workshop as part of the works to be constructed by the contractor (e.g. include the cost of the workshop in the contract price). An alternative approach may be to give the purchaser the right to acquire the workshop, if he so desires, after the completion of construction, at a reasonable price.

C. Construction to be effected by contractor

1. Machinery, tools and facilities for effecting construction

7. The contractor will need construction machinery (e.g. excavators, cranes, earth-movers) and tools (e.g. drills, saws) for effecting the construction. The contract should normally obligate the contractor to provide all construction machinery and tools needed for effecting the construction undertaken by him. In certain cases, however, the purchaser may be willing to supply the contractor with some of such construction machinery and tools. In such cases, the contract may enumerate the items to be supplied by the purchaser, and provide that the contractor is responsible for obtaining all other items needed by him. Furthermore, the contract should specify the rights and obligations of the parties in respect of such items (e.g. whether the items are to be sold or hired to the contractor, and the amount payable by the contractor in respect of the sale or hire or whether such amount has been included in the price). The contract should also address certain issues which will arise under such arrangements, for example, the dates on which the items are to be supplied, the quantity and quality of the items to be supplied, which party is responsible for maintenance and repairs, the purposes for which the items may be used, and which party bears the risk of loss of or damage to the items. The same issues will have to be addressed if the purchaser undertakes to construct a portion of the works and the contractor is willing to supply some of the items the purchaser needs for effecting the construction.

8. Special licences and authorizations (e.g. customs clearances) may be required in respect of construction machinery and tools imported by the contractor into the country of the site which the contractor wishes to re-export after the completion of the construction. The

purchaser should be obligated to assist the contractor in obtaining such licences and authorizations or to procure them on behalf of the contractor.

9. The parties may wish to determine how the transport needed for effecting the construction is to be provided. The contract may, for example, stipulate that one of the parties is to provide the vehicles needed, and may allocate responsibility in respect of the maintenance, repair and replacement of the vehicles.

2. Time for completion of construction

10. The contract should clearly set forth the time when the construction is to be completed by the contractor. The time for completion may be determined either by a fixed date or by reference to a period of time. If a fixed date is used, the contract should specify the situations in which this date may be postponed and a criterion for determining the length of postponement. If the contract requires construction to be completed within a specified period of time, the contract should specify when the period is to commence, under what circumstances it will cease to run or will be extended, and a criterion for determining the length of the extension.

11. The parties should usually agree upon the time for completion of construction in the contract, and should not leave such time to be determined after the contract has been concluded. If the time for completion is not agreed upon in the contract, and the parties later fail to agree upon this issue, it may be difficult for adjudicators in dispute settlement proceedings to fix a time for completion (see the chapter "Settlement of disputes").

12. In determining when a period of time for completion of construction is to commence, the following dates may be considered:

- (a) The date on which the contract enters into force;
- (b) The date on which the contractor receives notice from the purchaser that all licences for import of equipment and materials, and all official approvals for construction of the works required in the purchaser's country, have been granted to the purchaser, or that construction should begin;
- (c) The date of receipt by the contractor of an advance payment of a portion of the price to be made under the contract;
- (d) The date on which the purchaser delivers to the contractor documents defining the scope and quality of the works (e.g. designs, drawings) which are needed for the commencement of construction.

13. The contract might provide for the occurrence of more than one of the events mentioned in the preceding paragraph, in which case the time period should commence to run after all the events have occurred.

14. If only one contractor participates in the construction of the works, it would generally be in the interest of the purchaser for the construction to be completed as early as possible, and for the date fixed

for completion or the end of the period of time for completion to be considered as the final date for completion, with earlier completion being permissible or even encouraged (see the chapter "Price"). In some cases, however, the purchaser may not wish construction to be completed earlier for various practical reasons, including his financial arrangements. The contract should address the issue of early completion by the contractor and reflect the agreement of the parties on this issue.

3. *Time schedule for construction*

15. The contract should contain a time schedule to establish the sequential order in which construction on site is to take place. A time schedule is desirable in order to facilitate an evaluation of the progress of the construction. It may also facilitate the fixing of an extension of time for completion in the case of a variation or an impediment to construction (see the chapter "Completion, take-over and acceptance of the works"). The parties should agree upon the time schedule in the contract, since there may be difficulty in agreeing upon a time schedule at a later stage.

16. The time schedule may establish obligatory milestone dates for achieving progress in the course of construction. The purchaser may be entitled to order the contractor to speed up construction if it is evident that such milestone dates will not be met. A contractor who fails to meet such milestone dates should be liable for delay (see chapter "Failure to perform"). The time schedule should also reflect any obligations which the purchaser assumes under the contract in respect of the construction. The contractor should be obligated to deliver to the purchaser periodically during construction a report on the progress of construction.

17. The time schedule should be prepared in such a form (e.g. graphically) as would permit the actual progress of the construction to be recorded and compared with the time schedule. One method for designing the time schedule which the parties may wish to consider is the "critical path method". In this method, the entire construction is divided into individual tasks and each task is assigned a period of time within which it is to be performed. These periods are incorporated in a schematic diagram depicting the sequence and interrelationship of construction activities. Critical activities, i.e. activities on which other activities depend, form a continuous chain, known as the critical path, through the schematic diagram. This method may facilitate the evaluation of the consequences of delay in certain construction activities upon other such activities.

18. Where the separate contracts approach is adopted and several contractors are to participate in the construction (see the chapter "Choice of contract type"), each contract should include a time schedule of the sequence of construction under that contract to enable the purchaser to co-ordinate construction. The sequence of construction under each contract should be

harmonized with an overall time schedule for the construction of the entire works. However, in some cases it may not be possible to agree upon all the details of a time schedule at the time of the conclusion of the contract. For example, it may be possible to stipulate the period of time within which the construction required by a separate contract is to be completed, but not the date of commencement of construction. In these cases, the purchaser may be authorized to determine the time schedule by notifying it to the contractor within a specified period of time before commencement of construction. The contract may provide that if the purchaser requires the construction to commence before or after specified dates, the contractor would be entitled to a certain adjustment in the price. The contract may also provide that if the purchaser does not require the commencement of construction within a period specified in the contract, the contractor may be entitled to terminate the contract.

19. If the time for completion is extended, the time schedule for construction should by agreement be adapted to the new time for completion. Failure to agree on an adaptation of the time schedule should be settled in the same way as a failure to agree upon the consequences of a variation of construction (see the chapter "Variation clauses").

4. *Extension of time for completion of construction*

20. The time for completion of the construction specified in the contract, or an obligatory time for construction of a portion of the works under a time schedule, should be extended if certain events occur. The parties may wish to provide for such an extension in the following situations:

(a) The construction has been suspended by the purchaser for his convenience, or by the contractor because of the purchaser's failure to perform an obligation (see the chapters "Suspension of construction" and "Failure to perform");

(b) Work additional to that envisaged at the time of the conclusion of the contract has to be performed by the contractor due to a variation of the construction ordered by the purchaser (see the chapter "Variation clauses") or due to safety, environmental or other administrative regulations binding on the contractor which are issued after the conclusion of the contract (see the chapters "Price" and "Applicable law");

(c) Additional work has to be performed by the contractor to make good loss or damage the risk of which is borne by the purchaser, or to make good loss or damage caused by the purchaser, or a person engaged by the purchaser for construction (see the chapter "Allocation of risk of loss or damage");

(d) The purchaser, or a person engaged by him for construction, prevents the contractor from constructing the works in accordance with the contract;

(e) The construction is prevented as a result of an exempting impediment (see the chapter "Exemptions").

21. The contractor should be obligated to notify the purchaser promptly of the occurrence of any events which would entitle him to an extension of time for completion. Furthermore, the contractor should be obligated to notify the purchaser of the length of the extension which he wishes to have as soon as he is in a position to specify such length. If, within a specified period of time after the delivery of the latter notice, the parties fail to agree on the length of the extension which the contractor is to be given, the time for completion of the construction may be considered to be extended by a period of time reasonably needed for the completion (i.e. taking into account the period of time during which the construction was suspended, the amount of further construction which has to be effected, or the period of time during which the contractor was prevented from effecting the construction). This period may eventually have to be determined in dispute settlement proceedings (see chapter XL, "Settlement of disputes"). The contractor should not be entitled to stop construction pending or during such proceedings.

22. An extension of time for performance granted to the contractor may require some consequential measures to be taken in respect of insurance (see the chapter "Insurance") or in respect of security interests (see the chapter "Security for performance"), e.g. extension of the period of validity of bank guarantees.

D. Construction to be effected under contractor's supervision

23. If the separate contracts or the semi-turnkey contract approach is used for contracting (see chapter II, "Choice of contract type"), in addition to supplying equipment to be incorporated in the works, a separate or semi-turnkey contractor may assume the obligation to supervise construction to be effected either by the purchaser's personnel or by a local contractor engaged by the purchaser. Such an arrangement would, for example, enable the purchaser to pay some of his construction costs in local currency, thereby reducing his outflow of foreign exchange, or strengthen the technological capacity of the purchaser's country.

24. When the contractor is to supervise construction to be effected by the purchaser or by persons engaged by him, the contract should carefully specify the responsibilities of the parties in respect of the construction to be supervised. Usually, the contractor should be obligated to give the instructions concerning the technical aspects of the construction and to inspect such construction; and the purchaser or persons engaged by him should be obligated to carry out with proper skill and care the instructions given by the contractor. The instructions to be given by the contractor should take into consideration local laws and regulations (see the chapter "Applicable law"). The contract should obligate the purchaser, within a specified period of time before the commencement of the supervision by the contractor, to notify the contractor of the persons to whom instructions are to be given. The contractor should not be liable for defects in the construction if

such defects were caused by a failure of the purchaser or persons engaged by him to comply with the contractor's instructions. Where defects are caused by a failure of persons engaged by the purchaser to comply with the contractor's instructions, the contract may enable the contractor to avoid liability in two cases: firstly, if the defects could not reasonably have been discovered by the contractor in the course of his inspection; and secondly, if the defects could reasonably have been so discovered, the contractor notifies the purchaser of the defects at the time that the defects were reasonably discoverable.

25. In cases where the purchaser or persons to be engaged by him are capable of effecting the construction without instructions having to be given by the contractor, the contractor's obligations may be limited to inspecting the construction effected by such persons. In these cases the contractor would be liable only for failing properly to inspect the construction.

26. The contract may specify the qualifications required of the persons to carry out the supervision on behalf of the contractor and should obligate the contractor to notify the purchaser of persons authorized to carry out the supervision. The contract may indicate the estimated duration of construction to be supervised and the approximate time when it is to be effected. The contract may obligate the contractor to commence his supervision within a specified period of time after delivery to him by the purchaser of a notice to commence. The contractor should not be liable for any delay in the completion of the construction arising from a failure to perform by persons engaged by the purchaser.

E. Access to site and plant

27. The contractor, his sub-contractors and suppliers will need access to the site for the purposes of the construction. The purchaser, his consulting engineer, or other agents will also need access for certain purposes (e.g. to effect any construction undertaken by the purchaser, or to check the construction effected by the contractor). Third persons may also need access (e.g. insurance companies with which insurance has been effected may wish to inspect the plant from time to time). The contract should define the rights of access of each party and of third persons. The rights of access of public officers of the country of the site may be mandatorily established by the law of the country of the site.

28. In addition to establishing rights of access, the contract may determine which party is responsible for excluding persons who have no right of access. Where one contractor is in control of the entire site and the plant during construction (e.g. under the turnkey contract, comprehensive contract, and product-in-hand contract approaches, and possibly under the semi-turnkey contract approach), this contractor may be obligated under the contract to exclude persons with no right of access. In other cases (e.g. under the separate contracts approach), the purchaser may undertake this

obligation. It may be desirable to provide that whichever party undertakes this obligation must also take security measures in respect of the construction (against, for example, theft, arson, or damage to property).

29. Access to the site should include access to the area where construction is carried out and also to workshops, laboratories, stores, utilities, and other facilities created for the purposes of the construction. The extent and duration of the access needed by a contractor would depend on the construction obligations undertaken by him. Thus, a turnkey or comprehensive contractor who has undertaken to construct the entire works would need access to the entire site for the whole period of the construction. A separate contractor undertaking a portion of the construction may only need access of a limited duration to a limited portion of the site. Where the construction to be effected by one separate contractor is interrelated with the construction to be effected by another contractor, each contractor may need access to the site occupied and the construction effected by the other. In determining the access which one contractor is to have to the construction being effected by another, account should be taken of obligations as to confidentiality (e.g. with regard to drawings, specifications or technology) undertaken by the other contractor.

30. The purchaser and his consulting engineer should be entitled to access to the entire site and to the construction being effected at all times during the construction. The parties may, however, agree that other contractors, and suppliers of the purchaser, are to be excluded from the construction being effected by a contractor in order to ensure compliance with obligations as to confidentiality undertaken by the purchaser.

31. A right of access granted to a contractor should continue until take-over by the purchaser of the works or portion of the works constructed by the contractor. The contractor should also have a right of access for the purpose of participating in inspections and tests which take place after take-over. Moreover, the contractor should be entitled to access for the purposes of repairs which he is obligated to make.

F. Working conditions

32. In general, the contractor should be responsible for the working conditions of his own personnel on site, and accordingly the contract need not contain provisions dealing with such working conditions. However, the parties may wish to agree that certain obligations concerning such working conditions (e.g. obligations referred to in paras. 4 and 5, above) are to be assumed by the purchaser. The extent of such obligations will depend upon the type of contract in question. For example, in a turnkey contract where the contractor is responsible for all matters relating to the construction of the works, the obligations to be assumed by the purchaser may be minimal. However, in contracts in

which the control of the purchaser over the construction is more extensive, the obligations which the purchaser assumes with respect to working conditions may be more extensive.

33. The law of the country where the works is to be constructed may contain rules regulating certain matters relating to working conditions, such as working hours and holidays, and health and safety requirements. The contract should obligate the contractor to comply with all such rules. However, the purchaser might be obligated to assist the contractor in obtaining information concerning such rules.

G. Co-operation between parties

34. Co-operation between the parties in respect of construction activities on the site is essential for the smooth progress of the construction. The instances in which co-operation will be required are almost limitless and range from avoiding interference between personnel of one party with personnel of another party, to dealing with technical problems which arise during the course of construction. While it would be impossible for the contract to enumerate the instances in which co-operation will be required, it would nevertheless be desirable for the contract generally to obligate each party to co-operate with the other to the extent needed for the performance of each party's obligations, and to avoid conduct which interferes with such performance. When more than one contractor is to participate in the construction, each contractor should also be obligated to avoid conduct which interferes with the performance of the obligations of other contractors. The contract might also provide for the parties and the engineer to meet periodically, or at specified intervals, to discuss matters of common interest and to resolve outstanding issues concerning the construction of the works.

35. As one mechanism to promote co-operation between the parties, the contract might also provide for each party to appoint a liaison agent, who would be required to be present on site during working hours. The function and authority of the liaison agents should be essentially to serve as a means of communication between the parties involved in the day-to-day construction of the works. A liaison agent should be authorized to give and receive notices on behalf of the party appointing him.

H. Procurement by contractor on behalf of purchaser

36. In some situations, the parties may prefer some materials or other items needed for construction to be effected by the purchaser to be procured by the contractor on behalf of the purchaser. Such an arrangement could be of assistance to a purchaser in obtaining such items, since the contractor may be in a position to procure such items more efficiently or more inexpensively.

37. In connection with the procurement of supplies by the contractor on behalf of the purchaser, the contract might obligate the contractor to prepare the tender or purchase documents for the approval and signature of the purchaser and forward them to the suppliers; provide appropriate specifications for the supplies; obtain from the suppliers appropriate warranties with respect to the supplies (the warranties should be in favour of the purchaser); take delivery of the supplies; and inspect the supplies upon their delivery to the site.

38. The same reasons which make it desirable for the purchaser to participate in the selection of a sub-contractor (see the chapter "Sub-contracting") apply with equal, if not greater, force to the selection of third parties to provide supplies on behalf of the purchaser. Certain of the mechanisms discussed in the chapter for the selection of sub-contractors, such as tendering or pre-qualification mechanisms, may be adopted for the selection of suppliers on behalf of the purchaser, with appropriate modifications to account for the fact that the purchaser, and not the contractor, is to pay for such supplies.

I. Assistance by contractor in purchaser's contracting with third parties

39. Where the purchaser is to himself obtain supplies from third parties, the contract may require the contractor to assist the purchaser in obtaining such supplies. For example, the contract may obligate the contractor to advise the purchaser as to the specifications and quantities of supplies and the warranties which should be obtained from the suppliers. The contractor may also be obligated to ensure that the specifications for the supplies are suitable for the works, and to inspect the supplies upon their delivery to the site.

J. Clearance of site after completion

40. The contract should obligate the contractor periodically to clear the site of excess materials and waste. Furthermore, it should obligate him after take-over or acceptance of the works to remove in addition his construction machinery and tools, except those which he will need in order to repair defects during the guarantee period. If the purchaser does not wish to retain the workshop which has been provided (see para. 6, above), the contractor should also be obligated to remove it. For the contractor's obligations with respect to his construction machinery and tools when the contract is terminated, see the chapter "Termination".

[A/CN.9/WG.V/WP.15/Add.7]

Revised draft outline of the structure

1. The secretariat submitted to the fourth session of the Working Group a provisional draft outline of the

structure of the Guide (A/CN.9/WG.V/WP.9/Add.1). In the preparation of certain draft chapters of the Guide subsequent to that session, the secretariat has departed in some respects from the structure of the Guide as set forth in the provisional draft outline. In some cases this has resulted from discussions in the Working Group; in other cases this has resulted from further reflection by the secretariat on the structure of the Guide.

2. A revised draft outline reflecting these changes has therefore been prepared in order to present to the Working Group the draft structure of the Guide as it appears at the present stage of the work. The revised draft outline is set forth below.

Introduction

(Background to preparation of the Guide; scope and purpose of arrangement of subject-matters in the Guide, including context of new international economic order; arrangement of the Guide; terms used in the Guide; how to use the Guide)

Part one

Pre-contractual issues

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- A. General remarks
- B. Feasibility studies
- C. Considerations relevant to selection of parties
 - 1. Parties participating in construction
 - 2. Legal character of such parties, including consortia

Chapter II. Choice of contracting approach

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- B. Turnkey contract approach
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Chapter III. Procedure for concluding contract

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- B. Tendering
 - 1. Invitation to tender
 - 2. Form and contents of tenders
 - 3. Evaluation of tenders
- C. Negotiation (without prior tendering)
- D. Conclusion of contract
 - 1. Form of contract
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Part two

*Contractual provisions*Chapter IV. *General drafting considerations*

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- A. General remarks
- B. Language of contract
- C. Determination of parties to contract
- D. Definitions of key contract terms
- E. Contract provisions on interpretation
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- A. General remarks
- B. Scope and quality of works
 - 1. Scope of works
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 - 4. Hierarchy of documents
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- C. Quality guarantee
 - 1. Defects covered by guarantee
 - 2. Guarantee period
 - (a) Length of guarantee period
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- A. Supply by contractor
 - 1. Place of delivery
 - 2. Transport of equipment and materials
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- A. General remarks
- B. Preparatory work
- C. Construction to be effected by contractor
 - 1. Machinery, tools and facilities for effecting construction
 - 2. Time for completion of construction
 - 3. Time schedule for construction
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- D. Construction to be effected under contractor's supervision
- E. Access to site and plant
- F. Working conditions

- G. Co-operation between parties
- H. Procurement by contractor on behalf of purchaser
- I. Assistance by contractor in purchaser's contracting with third parties
- J. Clearance of site after completion

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- A. General remarks
- B. Authority and functions of consulting engineer
 - 1. Rendering services to purchaser
 - (a) Rendering advice and technical expertise to purchaser
 - (b) Acting on behalf of purchaser
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- C. Selection and replacement of consulting engineer
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- D. Ability of purchaser to claim directly against sub-contractor
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[A/CN.9/WG.V/WP.15/Add.8]

Choice of contracting approach*

Summary

A purchaser entering into contractual arrangements for the construction of industrial works should consider the different approaches available to him. He may enter into several separate contracts, each of a limited scope and dealing with different aspects of the construction, or he may enter into one or more of such contracts, and one or more works contracts, i.e. contracts of a broader scope which, as a minimum, impose the following obligations on the contractor: the supply of equipment, and either construction on site or supervision of such construction by others. Whichever approach is adopted, the purchaser will also participate to some degree in the construction (paragraphs 1 to 3).

Under the turnkey contract approach, a single contractor is engaged to construct the whole works and to supply everything needed for such construction, including the design, the technological process, and equipment and materials to be incorporated in the works. The contractor is liable if the works is not completed in time or is not in accordance with the contract, even if the failure is due to delay or defective performance by the contractor's sub-contractors or suppliers (paragraphs 5 to 11).

Under the comprehensive contract approach, a single contractor undertakes to construct the whole works in accordance with a design and incorporating a technological process supplied by the purchaser. He will be liable if the construction is not completed in time and in accordance with the design (paragraphs 12 and 13).

Under the product-in-hand contract approach, the contractor has the same responsibilities for the construction of the entire works as a turnkey contractor. However, he is, in addition, obligated to ensure that the works can be operated and the agreed production targets achieved by the purchaser's own staff. The contractor is thus obligated to train the purchaser's personnel and to operate and manage the works during an agreed test period (paragraphs 14 and 15).

Under the separate contracts approach, the purchaser enters into one or more works contracts and possibly one or more contracts of limited scope. Each contractor is responsible only for the equipment, materials and services supplied by him and the technology transferred by him. The purchaser must co-ordinate the scope and the execution of all of the contracts and must bear the risk of defects in the works or delays in its construction resulting from a failure of such co-ordination. The way in which the construction of the works is to be divided among the various contractors will depend upon the

*This draft chapter is a revised version of the draft chapter "Choice of contract type" (A/CN.9/WG.V/WP.9/Add.2). The substance of the section entitled "Contract types classified by pricing methods" in the latter draft chapter has been incorporated in the draft chapter "Price" (A/CN.9/WG.V/WP.15/Add.1).

nature and size of the works, as well as on financial considerations. However, a separation of the design of equipment from the supply and erection of the equipment may create problems for the purchaser.

The risks borne by the purchaser in connection with the co-ordination of separate contracts may be reduced by employing a third person, such as a construction manager or a consulting engineer, to effect such co-ordination (paragraphs 16 to 21).

Under the semi-turnkey contract approach, the semi-turnkey contractor supplies the design and essential equipment for the works and undertakes to effect a major portion of the construction. He must also define the scope and quality of the construction to be effected by other contractors. The semi-turnkey contractor also assumes certain limited responsibilities with respect to co-ordinating the construction process. The semi-turnkey contractor is responsible for handing over the completed works in accordance with the contract and can avoid this responsibility only in the event of a failure of another contractor to perform in accordance with the design and the time schedule (paragraphs 22 to 25).

* * *

A. General remarks

1. The purchaser entering into contractual arrangements for the construction of industrial works may adopt different approaches. He may enter into several separate contracts, each of a limited scope and dealing with different aspects of the construction, such as separate contracts for the design, for civil engineering, for the supply of equipment and materials, for erection of the plant and for the transfer of technology.¹ He may also enter into a combination of one or more of such contracts, and one or more works contracts, i.e. contracts of a broader scope which, at a minimum, impose the following obligations on the contractor: the supply of equipment, and either construction on the site or supervision of such construction by others. The term "construction" refers to building, civil engineering, or erection, or a combination of these processes (see the chapter "Construction on site"). Another approach may be for the purchaser solely to enter into one or more works contracts.

¹The Guide does not deal with the contents of these different types of contracts of limited scope (see introduction to the Guide). However, the discussion in the Guide of certain issues (e.g. exemption clauses, liquidated damages and penalties) in the context of works contracts may assist in understanding such issues in the context of contracts of limited scope. For negotiating and drafting contracts of limited scope, other guides and manuals elaborated by certain United Nations organs or specialized agencies may be used, such as UNIDO, *Manual on the Use of Consultants in Developing Countries* (United Nations publication, Sales No. E.72.II.B.10), ECE, *Guide for Use in Drawing up Contracts relating to the International Transfer of Know-how in the Engineering Industry* (TRADE/222/Rev.1) (United Nations publication, Sales No. E.70.II.E.15), ECE, *Guide for Drawing up International Contracts on Consulting Engineering, including some Related Aspects of Technical Assistance* (United Nations publication, Sales No. E.83.II.E.3) and WIPO, *Licensing Guide for Developing Countries* (WIPO publication No. 620(E)).

2. Whichever approach is adopted, the purchaser will participate to some degree in the construction. At a minimum, he will be expected to provide a site and the power and water needed for the construction, and will usually be obligated to procure the permits and authorizations needed for the construction under the law of the country in which the construction takes place (see the chapters "Construction on site" and "Applicable law").

3. Certain factors are relevant to the choice of an approach to contracting, such as how the technology to be used in the works, or the design for constructing the works, is to be obtained and how the construction process is to be co-ordinated. These factors are considered in the discussion of the various approaches to contracting described below. In choosing an approach to contracting, the purchaser should also consider the pricing method to be adopted under the contract. Certain pricing methods may not be appropriate to certain approaches to contracting (see the chapter "Price"). Moreover, institutions financing the construction may require certain approaches to contracting in order to reduce their risks. In addition, the parties should take into account the incidence of tax liability under different approaches to construction. Under the tax legislation of some countries, the contractor's profits under a turnkey contract may be taxed at a different rate as compared with his profits under a contract with lesser obligations (e.g. a turnkey contract may be considered as a sale of the works, and the profits taxed accordingly). Taxes to be borne by the contractor will usually be reflected in the price required by the contractor.

4. There does not at present appear to be a uniformly accepted terminology for describing the various forms of international works contracts. In the account that follows, the main characteristics of the most important approaches to contracting are described. The parties may, however, find it appropriate in certain circumstances to vary these approaches, or to combine certain features of two or more of them.

B. Turnkey contract approach

5. Under the turnkey contract approach, a single contractor is engaged to construct the whole works; his obligations would normally cover the design of the works, the supply of an appropriate technological process to be used in the works, the supply of equipment and materials to be incorporated in the works, civil engineering, building, and erection of equipment. The contractor would be obligated to complete construction of the works by a specified date and in accordance with the contract (e.g. to construct works which will produce goods of a quality and quantity stipulated in the contract). The contractor would be liable where the works is not completed in time or is not in accordance with the contract, even if the failure was due to delay or defective performance by the contractor's sub-contractors or suppliers (see the chapters "Failure to perform" and "Exemptions").

6. If the turnkey contractor does not himself possess the technological process to be used in the works, he should be obligated to obtain it from a supplier and should be responsible for the performance of the technological process to the same extent as if the process were his own. If the technological process is highly complex, it may be necessary to enter into a turnkey contract with the technology supplier, since only the supplier may have the knowledge required to design and construct works embodying that technological process.

7. The main advantage of the turnkey contract approach for the purchaser is that a single entity is liable if the construction is not completed in time, or the works fail to operate as required under the contract. The turnkey contract approach may be useful especially in developing countries which are in the early stages of industrialization, where local technological capabilities are limited and where it is therefore important to ensure that complete responsibility for all aspects of the construction is assumed by a contractor having the necessary experience in the relevant field.

8. Where offers are solicited for the construction of the works on a turnkey basis, the purchaser will obtain the benefit of competition in respect of the design for the works, since each offer will generally reflect a different design. Under the comprehensive contract approach (see paras. 12 and 13, below) or the separate contracts approach (see paras. 16-21, below), a single design is usually provided by a professional, and offers are solicited for the construction on the basis of this design. Where a design is prepared by a turnkey contractor who is himself to effect the manufacture and construction pursuant to that design, the design is likely to result in construction which is economical and efficient, since the design will reflect manufacturing and construction economies, and construction techniques, available to the contractor. In addition, a turnkey contractor will have an incentive not to overdesign the works, since to do so would make his tender uncompetitive.

9. The turnkey contract approach may have certain disadvantages. For example, it may be difficult for the purchaser to evaluate and compare different turnkey offers, since each such offer will reflect a different design and a different combination of construction elements and methods. Furthermore, in their decisions on design, construction methods, and selection of sub-contractors, contractors may be motivated more by their desire to offer an attractive price than by such matters as the durability, reliability and ease of maintenance of the works.

10. Furthermore, the total cost of the works may be higher for the same scope of construction if the turnkey approach is adopted than if the separate contracts approach (see paras. 16-21, below) or the semi-turnkey contract approach (see paras. 22-25, below) is adopted. Under the turnkey contract approach, the contractor bears a high degree of risk, since he is obligated to effect the entire construction and to co-ordinate the construction process. The contractor will wish to insure

against such risk or provide financial reserves to cover the risk, and the costs of adopting these measures may be reflected in the price. Under the separate contracts approach and the semi-turnkey contract approach, however, the scope of construction undertaken by each contractor is more limited, and the risks involved in co-ordinating the construction process are borne (under the separate contracts approach) entirely or (under the semi-turnkey contract approach) partially by the purchaser. In addition, turnkey contractors would usually include in prices quoted by them an increment to cover their expenses in preparing and submitting unsuccessful offers on a turnkey basis for the construction of other projects.

11. In some countries, civil engineering or the supply of certain types of equipment or services for works to be constructed in those countries may be reserved for suppliers from those countries. Furthermore, purchasers in developing countries may wish that local enterprises be engaged as sub-contractors or suppliers in order to develop the technological capabilities of those enterprises and to conserve foreign exchange. However, because of the extensive obligations undertaken by him, a turnkey contractor may insist on the right to engage sub-contractors of his choice on whom he can rely. In such cases it may not be possible to enter into a turnkey contract.

C. *Comprehensive contract approach*

12. The term "comprehensive contract" is often used to refer to a contract under which a single contractor undertakes to construct the whole works in accordance with a design supplied by the purchaser. The technological process to be used in the works will also be supplied by the purchaser. In contrast to the turnkey contract approach, therefore, the comprehensive contractor will not be liable if the works are not in accordance with the contract due either to a defective technological process or defective design. He will only be liable if the construction is not completed in time and in accordance with the design.

13. The main advantage of the comprehensive contract approach for the purchaser is that, as under the turnkey contract approach, a single contractor is obligated to construct the entire works and to co-ordinate the construction process. An additional advantage of the comprehensive contract approach, as compared to the turnkey contract approach, is that offers made by contractors for a comprehensive contract can be easily compared, since the offers are based on the same design (see para. 9, above). Furthermore, under this approach, unlike under the turnkey contract approach, the professional preparing the design will not have an incentive to sacrifice considerations of durability, reliability and ease of maintenance of the works in order to achieve an attractive price. This professional, who can effectively check if the works is being constructed in accordance with the design, may be engaged by the purchaser to supervise the construction.

D. *Product-in-hand contract approach*

14. Under the product-in-hand contract approach (the French term *produit en main* is often used in practice), the contractor has the same responsibilities for the construction of the entire works and the co-ordination of the construction process as under a turnkey contract. In addition, he is obligated to show during a test period specified in the contract that the works can be operated and agreed production targets achieved by the purchaser's own staff, using the raw materials and other inputs that the purchaser would use. The product-in-hand contract, therefore, places extensive obligations on the contractor, including the obligation to train the purchaser's personnel, and to operate and to manage the works during the agreed test period. The acceptance of the works by the purchaser (see the chapter "Completion, take-over and acceptance") would occur only if the contractor successfully discharges these obligations. The use of the product-in-hand contract approach has, however, been limited in practice.

15. In general, the product-in-hand contract approach has all the advantages and disadvantages of the turnkey contract approach. Since the contractor must show that the purchaser's staff can operate and manage the works, this approach has the additional advantage that an effective transfer of technical and managerial skills may be achieved. However, as the contractor's obligations and risks are greater than under a turnkey contract, the total cost under the product-in-hand contract approach may be considerably higher than under the turnkey contract approach. Another disadvantage may be that the purchaser's freedom to select personnel to operate the works is limited, as the contractor may insist that the personnel for whose training he is responsible should be chosen by him.

E. *Separate contracts approach*

16. Under the separate contracts approach, the purchaser enters into one or more works contracts, and may in addition enter into one or more contracts of limited scope (see para. 1, above). Each contractor under a works contract would be responsible only for the equipment, materials and services supplied by him, and the technology transferred by him. Since the construction of the whole works is divided among two or more contracts, the purchaser must co-ordinate the scope and the execution of these contracts, and must bear the risk of defects in the works or delays in its construction resulting from a failure of such co-ordination.

17. The way in which the construction is to be divided among the various contractors will depend on the nature and size of the works, as well as on financial considerations. In general, the smaller the scope of the works, the fewer the number of separate contractors required and the easier it is for the purchaser to co-ordinate the scope and execution of the construction to be effected by the contractors. The risks connected with such co-ordination increase when a large number of

contractors or other persons participate in the construction.

18. In addition to a potentially lower cost (see para. 10, above), a significant advantage of the separate contracts approach for the purchaser is that he retains control over the construction, and the persons involved in it. In particular, he has more flexibility in making changes in the scope and manner of the construction than when all construction obligations are integrated within a single contract. Furthermore, purchasers from developing countries may engage local contractors for the construction of some portions of the works under the supervision of experienced foreign contractors engaged for the construction of other portions of the works. This may save foreign exchange and facilitate the transfer of technical and managerial skills to enterprises in the purchaser's country. In such cases, the respective responsibilities of the local contractors and the foreign contractor should be clearly stipulated in the contracts concluded by the purchaser in order to avoid disputes and difficulties during the construction process.

19. If the works fails to operate, the purchaser must discover which contractor is responsible for the failure in order to obtain a remedy. Since the construction to be effected by the several contractors is sometimes complex and interrelated, this may in some cases be difficult. Moreover, if a failure to perform by one contractor has repercussions on the work of the others, the purchaser may be liable to compensate the others for losses suffered by them, provided that they have performed or were ready to perform their contractual obligations. In respect of such compensation paid by him, the purchaser may be entitled to liquidated damages or penalties, or to indemnification, from the contractor who was responsible for the failure. However, the possibility of recourse by the purchaser against the contractor to recover compensation paid by the purchaser to other contractors may be limited by the contract or the applicable law. As a result, the purchaser may have to bear some portion of the damage caused to him by the contractor who failed to perform.

20. The purchaser may also wish to note that if the design of equipment is to be supplied by a person different from the contractor who is to supply and erect the equipment, in cases where the works is found to be incapable of operating in accordance with the contract, it may be difficult for the purchaser to prove whether this failure was due to a defect in the design or a defect in the equipment or its erection. This problem may be reduced by stipulating in the contract that such a contractor is obligated to notify the purchaser of defects in the design which he could reasonably discover.

21. The risks borne by the purchaser in connection with the co-ordination of the scope and execution of separate contracts may be reduced by employing a third person who is an expert in this field, such as a construction manager or a consulting engineer, to effect

such co-ordination. The obligations of such a third person may include planning, inviting tenders, co-ordinating site activities and checking the process of construction. He may also be given the responsibility to negotiate and conclude on behalf of the purchaser contracts with separate contractors who are to effect various portions of the construction. In the latter case, the third person should be made responsible for his negligence in the selection of the contractors but not for failures of performance by the contractors.

F. *Semi-turnkey contract approach*

22. The semi-turnkey contractor supplies the design for the works, undertakes to effect a major portion of the construction, and supplies the essential equipment needed for the use of the technological process. The semi-turnkey contractor must also define the scope and quality of the construction which is to be effected by others. Such construction would be effected by other contractors under individual contracts concluded by them with the purchaser. The purchaser may also effect some of the construction.

23. The semi-turnkey contractor also assumes certain responsibilities of a limited scope in regard to co-ordinating the construction process. He would usually, in agreement with the purchaser, define the scope of the work to be effected by each contractor engaged by the purchaser and provide specifications and a time schedule for such work. The semi-turnkey contractor may also undertake to check the construction effected by the other contractors, and to notify the purchaser of defects or delay in such construction which he could reasonably discover.

24. An advantage of the semi-turnkey contract approach is that the semi-turnkey contractor is responsible for handing over to the purchaser at an agreed time completed works which is in accordance with the contract. He would not be so responsible only if the construction to be effected by other contractors had not been effected in accordance with the design provided by the semi-turnkey contractor, or in accordance with the specifications and time schedule agreed upon between the semi-turnkey contractor and the purchaser.

25. As with the turnkey contract approach, an advantage of the semi-turnkey contract approach is that the design of the works and the supply of the essential equipment needed for the use of the technological process are effected by one person, resulting in manufacturing and construction economies. However, as with the turnkey contract approach, the fact that each contractor making an offer to construct on a semi-turnkey basis will submit his own design may make it more difficult to compare bids made by various semi-turnkey contractors (see para. 9, above). Another advantage of the semi-turnkey contract approach for the purchaser is that he maintains complete freedom to select contractors to construct the portions of the works which are not to be constructed by the semi-turnkey

contractor. In respect of the same scope of construction, the cost may, however, be higher than under the separate contracts approach, since under the latter approach the risks connected with co-ordination are entirely borne by the purchaser.

[A/CN.9/WG.V/WP.15/Add.9]

Completion, take-over and acceptance

Summary

The contract should clearly establish when completion, take-over and acceptance occur and the legal consequences of their occurrence. In general, the contract may provide that the completion of construction occurs when equipment, materials and services required under the contract have been supplied by the contractor, and such supply has been proved through successful mechanical completion tests. The contract may provide that take-over occurs when the purchaser takes physical possession, either of the works after completion of construction or of the plant before completion of construction. Acceptance may occur if the purchaser indicates his approval of the construction. However, such approval may be deemed to have been given in certain circumstances (paragraph 1).

Whether completion, take-over and acceptance should all occur, as well as the sequence in which these events should occur, depends on a number of factors, and in particular upon the choice of approach to contracting made by the purchaser (paragraphs 2 and 3).

When the contractor considers the construction to have been completed, he should be obligated to notify the purchaser and to prove such completion through the conduct of successful mechanical completion tests. It is desirable that the contract set forth the procedures to be followed in conducting such tests. The construction may be considered to be completed even if the mechanical completion tests disclose that certain minor items have not been supplied (paragraphs 4 to 11).

The results of the mechanical completion tests should be reflected in a protocol signed by both parties. However, if the purchaser fails to attend the tests, a protocol may be signed by the contractor and sent promptly to the purchaser (paragraph 12). The contract should establish the time at which construction may be considered to have been completed (paragraph 13).

The purchaser usually takes over the works after completion of construction. After take-over, the works are usually operated for a trial period. In some cases, however, the works may be taken over by the purchaser after acceptance. If the contract provides for a trial operation period, it should also provide for the allocation of costs connected with the operation of the works during this period (paragraphs 14 to 16).

In some cases, the plant may be taken over before completion of construction, such as when the contract is

terminated by the purchaser due to a failure by the contractor to perform his obligations in accordance with the contract or when the purchaser, as a remedy for a failure to perform by the contractor, chooses to complete the construction by engaging a new contractor at the expense and risk of the contractor (paragraphs 17 and 18).

In all cases of take-over it may be advisable for the contract to require a take-over protocol (paragraph 19). The contract should provide for the legal effects of take-over (paragraph 20).

Acceptance of the construction by the purchaser normally indicates the end of the construction process. The contract should set forth the circumstances in which acceptance is to occur (paragraphs 21 and 22).

The contract should establish the timing of the performance tests and the procedures to be followed in conducting such tests (paragraphs 24 to 31).

The contract should clearly stipulate when acceptance occurs, as well as the legal effects of acceptance (paragraphs 32 to 34; see also paragraph 23). It may be advisable for the contract to require an acceptance protocol, signed by both parties, in which the acceptance of the construction by the purchaser would be confirmed (paragraphs 35 and 36).

* * *

A. General remarks

1. The contract should clearly establish when completion, take-over and acceptance occur, and the legal consequences of their occurrence. In general, the contract may provide that the completion of construction occurs when equipment, materials and services required under the contract have been supplied by the contractor and such supply has been proved through successful mechanical completion tests. The contract may provide that take-over occurs when the purchaser takes physical possession, either of the works after completion of construction or of the plant before completion of construction (e.g. upon termination of the contract). The contract may provide that acceptance occurs if the purchaser indicates his approval of the construction. However, such approval may be deemed to be given in certain circumstances.

2. Whether completion, take-over and acceptance should all occur, as well as the sequence in which these events should occur, depends upon a number of factors and in particular upon the choice of approach to contracting made by the purchaser (see the chapter "Choice of contract type"). In general, completion of construction should occur first, such completion being proved by mechanical completion tests. The purchaser may have chosen an approach to contracting under which a single contractor is to effect the entire construction (e.g. turnkey contract approach or comprehensive contract approach) or the major portion of the

construction (e.g. semi-turnkey contract approach). In such cases it is usual that after completion the purchaser takes over the works, and that the works is operated for a trial period. At the end of the trial period, performance tests are conducted, and if these are successful, acceptance occurs. In certain cases, however, this sequence may not be followed. The period of trial operation may take place prior to take-over in cases where the contractor is in physical possession of the works during the trial period (e.g. under the product-in-hand contract approach, where the contractor has undertaken to train the purchaser's personnel to operate the works). At the end of the trial period, performance tests are conducted, and if these are successful, acceptance and take-over occur. In some cases, the contract may not provide for a trial operation period; in such cases, acceptance may occur after successful performance tests following completion, with take-over occurring after acceptance. Furthermore, in the cases where the contract is terminated before completion of construction, only take-over by the purchaser may occur.

3. If the separate contracts approach to contracting is chosen by the contractor, different situations may occur which need to be distinguished. The separate contractor may, during the portion of the construction to be effected by him, be in physical possession of the plant. In such cases, after completion of the portion of the construction, the purchaser may take over the plant. Such take-over may be followed by acceptance, if performance tests can be conducted in respect of the plant and the tests are successful. In many cases, however, it may be possible to conduct performance tests only after the entire construction has been completed. In such cases, take-over may occur after completion of the portion of construction, but performance tests and acceptance would not occur until after the entire construction has been completed. In some cases, several separate contractors will be effecting construction on the site simultaneously, and the purchaser will be in physical possession of the plant. In such cases, no take-over by the purchaser would be necessary, and completion may, at an appropriate stage, be followed by acceptance.

B. Completion of construction

1. Proof of completion: mechanical completion tests

4. When the contractor considers the construction to have been completed, he should be obligated to notify the purchaser and to prove such completion through the conduct of successful mechanical completion tests. The construction may be considered to be completed even if the mechanical completion tests disclose that certain minor items (i.e. items the absence of which does not prevent the conduct of performance tests or the operation of the works) have not been supplied. The absence of these items may be considered not as delay in completion, but as defects in the works (see the chapter "Failure to perform").

5. It is desirable that the contract set forth the procedures to be followed in conducting mechanical completion tests. These tests should usually include such of the following as are appropriate to the construction effected: visual inspection of the works and its components; checking and calibration of instruments; safety tests; dry runs; mechanical operation of the works and its various components; inspection of the technical documentation which the contractor has to supply for operation and maintenance of the works (e.g. as-built plans, manuals of instruction, and lists of spare parts); and inspection of the stock of spare parts and materials which the contractor may have to deliver with the works.

6. The contract may obligate the contractor to perform mechanical completion tests required by the purchaser which are additional to, or deviate from, the tests described in the contract. However, if such additional or modified tests are not standard practice in the industry in relation to the works which has been constructed, the contractor should be entitled to disclaim liability for damage which may be caused to the works by such tests.

7. In general, the costs connected with conducting mechanical completion tests should be borne by the contractor. However, the purchaser may undertake to supply at his expense some materials and energy needed for the operation of the works during the tests. The contract should determine which party is to bear the costs of additional or modified tests. The contractor may be obligated to bear such costs if such tests are standard practice in the industry.

8. Mechanical completion tests should be conducted within a specified period of time after the notification of completion by the contractor. If the parties fail to agree upon a date within this period of time for the commencement of the tests, the tests should commence on the last day of such period. In some cases, the parties may wish to stipulate in the contract that the mechanical completion tests in respect of some portions of the construction may be conducted even before completion of the entire construction to be effected under the contract.

9. The contractor should be responsible for conducting the mechanical completion tests. The tests should be conducted in the presence of both parties. If the purchaser fails to attend the tests, the contractor should be entitled to conduct the tests in the absence of the purchaser. In such a case, the contractor should be obligated promptly to inform the purchaser of the results of the tests. However, if the purchaser is prevented from attending the tests by an exempting impediment (see the chapter "Exemptions"), he should be entitled to ask within a specified or reasonable period of time after the occurrence of the exempting impediment that the tests be postponed or repeated at his own expense.

10. If successful mechanical completion tests cannot be conducted at the time provided for in the contract

due to causes for which the contractor is responsible, and the tests must be extended, postponed or repeated, all costs incurred by the purchaser which he would not have incurred if the tests had not been extended, postponed or repeated should be borne by the contractor. If the tests must be extended, postponed or repeated due to causes for which neither party is responsible, the costs of the tests should be borne as set forth in the contract, and each party should bear any additional costs incurred by him. If the tests must be extended, postponed or repeated due to causes for which the purchaser is responsible, the purchaser should bear all costs incurred by the contractor which the contractor would not have incurred if the tests had not been extended, postponed or repeated. In addition, the contract may provide that the construction is presumed to be completed if the tests cannot be conducted, due to causes for which the purchaser is responsible, after the expiry of a specified period of time commencing to run on the date when the tests were originally scheduled to begin.

11. If certain formalities (e.g. the participation of an inspecting organisation) are required for the conduct of the mechanical completion tests, and such formalities cannot be complied with due to causes for which the contractor is not responsible, the tests should be conducted without complying with the formalities, unless mandatory rules in force in the country of the site require compliance with such formalities.

2. *Mechanical completion test protocol*

12. The results of the mechanical completion tests should be reflected in a protocol signed by both parties, unless the purchaser has failed to attend the tests. The protocol should indicate the results of the mechanical completion tests and specify the items which were discovered to be missing and the period of time within which they should be supplied. The protocol should indicate the date when the tests were completed. If the tests are unsuccessful, the protocol may indicate a date when the tests are to be repeated. Any differences concerning the readings or the evaluation of the tests should be reflected in the protocol. In case of such differences, the contract should provide that either party may call immediately upon an independent expert to make the necessary assessment of the facts (see the chapter "Settlement of disputes"). If the purchaser fails to attend the tests, a protocol may be signed by the contractor and sent promptly to the purchaser.

3. *Time of completion of construction*

13. If the results of the mechanical completion tests are successful, the construction may be considered to have been completed as of the date proposed by the contractor for the commencement of the tests or, alternatively, on the date of the completion of the tests. However, if the latter date is chosen as the date of completion, the contract should provide that if, due to obstacles for which the contractor is not responsible,

the tests cannot be completed by the time set forth in the contract for the completion of construction, the contractor is not to be regarded as being in delay in completion.

C. *Take-over of works*

1. *Take-over after completion of construction*

14. The purchaser usually takes over the works upon completion of construction. The parties may wish to provide in the contract that the works is to be taken over within a specified period of time after completion of successful mechanical completion tests. After take-over, the works are usually operated for a trial period. The trial operation enables the works to be run in and reach normal operating conditions. Performance tests may thereafter be conducted, and the performance of the works will be evaluated under normal operating conditions. The trial operation also enables the purchaser's personnel to become fully acquainted with the works. The contractor should be obligated to provide technical supervision during the trial operation.

15. In some cases (e.g. when the contractor undertakes to train the purchaser's personnel to operate the works), the works may remain in the physical possession of the contractor during the trial operation period, and the works may be taken over by the purchaser only after the conduct of successful performance tests and acceptance of the construction by the purchaser. In such cases, the contractor may be obligated, in addition to training the purchaser's personnel, to operate, protect, and maintain the works. The works may also be taken over by the purchaser after his acceptance of the construction in cases where the contract does not provide for a trial operation period. The contract should obligate the purchaser to take over the works within a short period of time, to be specified in the contract, after acceptance.

16. The contract should provide for the allocation of costs connected with the operation of the works during the trial period. How the costs should be allocated may depend upon the pricing method (see the chapter "Price") used in the contract (e.g. under the product-in-hand contract approach, the costs of training the purchaser's personnel during this period would be borne by the contractor). The output of the works should be owned by the purchaser. The contract should specify the length of the trial operation period and the circumstances in which such period may be extended.

2. *Take-over before completion of construction*

(a) *Take-over in case of termination of contract*

17. Where the purchaser terminates the contract due to a failure by the contractor to perform his obligations in accordance with the contract, or where the contract is terminated for other reasons, e.g. due to the continuance of exempting impediments for a specified

period of time (see the chapter "Termination"), the purchaser should take over the plant already constructed to the extent that it can be used in the completion of the construction. Take-over should be effected within a short period of time, to be specified in the contract, after the termination has become effective. However, in the case of termination of the contract by the contractor due to a failure of performance by the purchaser, the purchaser should not be entitled to take over the plant if such take-over would be inconsistent with the rights of the contractor arising from such a failure (e.g. with the rights of the contractor under a reservation of ownership; see the chapter "Transfer of ownership of property").

(b) *Take-over in case of completion of construction at contractor's expense and risk by another contractor*

18. If the contract enables the purchaser, as one of his remedies in the event of a failure to perform by the contractor, to complete the construction by a new contractor at the expense and risk of the contractor, the contract should provide that if the purchaser chooses this remedy, the purchaser should take over the plant at the time when the contractor leaves the site (see the chapter "Failure to perform").

3. *Take-over protocol*

19. In all cases of take-over it may be advisable for the contract to require a take-over protocol, to be signed by both parties, which would indicate the date of take-over and the condition of the works at the time of take-over. However, a separate protocol may not be needed if take-over is to occur immediately after the acceptance of the construction. In such cases, the take-over may be reflected in an acceptance protocol (see paras. 35 and 36, below).

4. *Legal effects of take-over*

20. The main legal effect of the take-over of the works by the purchaser should be that the risk of loss of or damage to the works passes from the contractor to the purchaser (see the chapter "Allocation of risk of loss or damage"). In addition, take-over may give rise to an obligation of the purchaser to pay a portion of the price (see the chapter "Price"). Take-over, and the consequential passing of risk, may also affect the insurance covering the works (see the chapter "Insurance"). The date of take-over may be relevant to determining the commencement of the trial operation period (see para. 14, above).

D. *Acceptance of construction*

21. Acceptance of the construction by the purchaser normally indicates the end of the construction process. Acceptance may occur where the purchaser approves the construction, or where the contract deems acceptance to have occurred.

22. Where the separate contracts approach is adopted, if different portions of the construction are completed at different times and these portions can be tested (if performance tests are to be conducted in respect of such portions) and operated independently, the contract may provide for each portion to be accepted separately. In such cases, the same rules should apply as in respect of acceptance of the entire construction. In some cases, however, it may not be possible to test or put into operation the equipment supplied and erected by one of the contractors before the entire construction is completed. In such cases, the conduct of performance tests and acceptance should not occur until the completion of the entire construction.

23. It is generally not advisable for the contract to provide for provisional acceptance (i.e. acceptance subject to certain conditions, such as the cure by the contractor of defects discovered during performance tests). Take-over could achieve the same objectives as those intended to be achieved through provisional acceptance. Provisional acceptance could result in undesirable consequences, such as the termination of a security for performance or of an insurance policy which is to terminate upon acceptance. If the parties do prefer to provide for provisional acceptance, the contract should define the situations in which provisional acceptance may occur and what its effects are to be. The contract should clarify in particular whether the legal effects of acceptance (see para. 34, below) are to be postponed until the time when the condition giving rise to the provisional nature of the acceptance is satisfied.

1. *Performance tests*

24. The purpose of performance tests is to show that the works meets the performance standards specified in the contract. These performance standards may relate not only to the output and its qualities but also to a number of other parameters, such as consumption of energy and feedstock or other materials. The tests may also be intended to demonstrate the performance of the works under a variety of conditions.

25. The contractor should be responsible for conducting the performance tests at his own expense. The purchaser may, however, undertake to supply some materials and energy needed for the operation of the works during the tests. The contract should provide that the performance tests are to commence at the end of the trial operation period, if any. If no trial operation is to be provided, the contract should specify a period of time after successful mechanical completion tests have been conducted within which performance tests should commence. The contract should provide that if the parties fail to agree on a date for the commencement of the tests within this period of time, the tests should commence on the last day of such period.

26. The contract should set forth the procedures for the conduct of the performance tests. It should establish

the duration of the tests, the criteria for performance, the methods of measurement and analysis, the tolerances and the number of times unsuccessful tests may be repeated. The performance tests should be considered to be successful if the performance standards specified in the contract with permitted tolerances are met.

27. It is not infrequent that, due to variations in the course of construction of the works and due to differences in feedstock, materials and energy supply, the parameters for the performance of the works as finally constructed differ from those originally specified. For example, during the course of construction of the plant the purchaser may decide on a different source for raw materials and feedstock, or his own raw materials and feedstock may have characteristics different from those originally considered. Such differences will affect the performance and the output of the works, and the performance tests procedures, to the extent possible, should provide for appropriate adjustments in such cases.

28. The performance tests should be conducted in the presence of both parties. If the purchaser fails to attend the performance tests, the contractor may be entitled to conduct the tests in the absence of the purchaser. In such a case, the contractor should be obligated promptly to inform the purchaser of the results of the tests. However, if the purchaser is prevented from attending the tests by an exempting impediment (see the chapter "Exemptions"), he should be entitled to ask within a specified or a reasonable period of time from the occurrence of the exempting impediment that the tests be postponed or repeated at his own expense.

29. If successful performance tests cannot be conducted at the time provided for in the contract due to causes for which the contractor is responsible and must be extended, postponed or repeated, all costs incurred by the purchaser which he would not have incurred if the tests had not been extended, postponed or repeated should be borne by the contractor. If the performance tests must be extended, postponed or repeated due to causes for which neither party is responsible, the costs of the tests should be borne as set forth in the contract, and each party should bear any additional costs incurred by him. If the performance tests must be extended, postponed or repeated due to causes for which the purchaser is responsible, the purchaser should bear all costs incurred by the contractor which the contractor would not have incurred if the tests had not been extended, postponed or repeated.

30. If certain formalities (e.g. the participation of an inspecting organisation) are required for the conduct of the performance tests and such formalities cannot be complied with due to causes for which the contractor is not responsible, the tests should be conducted without complying with such formalities, unless mandatory rules in force in the country of the site require compliance with such formalities.

2. *Performance test protocol*

31. The test procedures, readings and results should normally be recorded and evaluated and be set forth in a performance test protocol. The protocol should be signed by both parties, unless the purchaser has failed to attend the tests. The protocol should indicate the date when the tests were completed. If the tests are unsuccessful, the protocol may indicate a date when the tests are to be repeated. Any differences concerning the readings or the evaluation of the tests should be reflected in the protocol. In case of such differences, the contract should provide that either party may call immediately upon an independent expert to make the necessary assessment of the facts (see the chapter "Settlement of disputes"). If the purchaser fails to attend the tests, a protocol may be signed by the contractor and sent promptly to the purchaser. Instead of executing a performance test protocol, however, the parties might wish in appropriate cases to include the results of the performance tests in an acceptance protocol (see paras. 35 and 36, below).

3. *Time of acceptance*

32. As acceptance of the works has significant legal effects, the contract should clearly stipulate when acceptance occurs. If an acceptance protocol is signed by both parties, the time of acceptance should be the date indicated in the protocol. If no such date is indicated in the protocol, the date on which the protocol was signed by the parties may be considered to be the time of acceptance. If no acceptance protocol is signed by the parties (e.g. due to a failure by the purchaser to attend the performance tests or a dispute between the parties as to whether the performance tests were successful), the date on which the performance tests have been successfully completed should be considered as the time of acceptance.

33. If the performance tests cannot be conducted on the scheduled date for causes for which the purchaser is responsible, and this impossibility persists for a period of time to be specified in the contract, acceptance may be considered to occur on the date when a notice to that effect is delivered by the contractor to the purchaser, provided such delivery is effected after expiry of such period of time. If the performance tests cannot be conducted on the scheduled date for causes for which neither party is responsible and this impossibility persists for a period of time to be specified in the contract, the contract may provide that the works should be put into operation and, if operated successfully during the period of time during which the performance tests were to be conducted, that acceptance occurs after expiry of such period, provided that the performance standards achieved during such operation correspond to the performance standards required in the contract. In cases where performance tests are not required under the contract and the purchaser does not approve the construction within a specified period of time, acceptance may be considered to occur at the time when completion of construction is proved, unless

serious defects in the works have been discovered which entitle the purchaser to refuse to accept the works (see the chapter "Failure to perform").

4. *Legal effects of acceptance*

34. The contract should clearly set forth the legal effects of acceptance. The period for the quality guarantee in respect of the works should generally commence to run at the time of acceptance. This may also apply to a quality guarantee in respect of a portion of the construction (e.g. a power station) if such a portion is to be operated by the purchaser even before completion of the entire construction. However, if such an accepted portion of the construction is not to be operated until completion of the entire construction, the guarantee period should commence to run at the time of acceptance of the entire construction. In some cases, the contractor may be obligated to insure the plant against risk of loss or damage during construction and the works from the time of completion until the works has been accepted by the purchaser. The purchaser may be obligated to pay a portion of the price within a specified period of time after acceptance (see the chapter "Price"). The purchaser may be obligated to take over the works after acceptance if take-over had not previously occurred.

5. *Acceptance protocol*

35. It may be advisable for the contract to require an acceptance protocol, signed by both parties, in which the acceptance of the construction by the purchaser would be confirmed. A protocol which is binding on both parties is preferable to a unilateral act evidencing acceptance. Such a protocol would minimize disputes as to whether and on what date the works had been accepted. In addition, by means of an acceptance protocol, the purchaser could indicate his acceptance of the construction in cases where acceptance would not otherwise occur.

36. The acceptance protocol should identify the construction which has been accepted by the purchaser and indicate the date of acceptance. Normally, this should be the date when the performance tests have been successfully completed. The acceptance protocol may evaluate the results of the performance tests if these results have not already been evaluated in a performance test protocol (see para. 31, above). Where the purchaser has decided to accept the works despite certain defects, the acceptance protocol may contain a list of the defects in the works, e.g. a list of the items discovered during the mechanical completion tests to be missing (unless they had been supplied prior to acceptance) (see para. 4, above), as well as the defects discovered during the performance tests. In addition, it may be advisable to include in the protocol a time schedule for the supply of the missing items and the cure of the defects, unless the parties have agreed to other remedies such as a reduction of the price. If the parties differ as to certain issues, such as the time

schedule for the cure of discovered defects, the protocol should reflect the views of both parties and the differences should be settled in dispute settlement proceedings (see the chapter "Settlement of disputes"). The protocol may also indicate certain measures to be taken by the parties in connection with acceptance, e.g. assignment of rights under an insurance policy.

[A/CN.9/WG.V/WP.15/Add.10]

Procedure for concluding contract

Summary

There are in practice two basic approaches to the conclusion of a works contract. Under the first approach, the purchaser invites tenders from enterprises to construct the works, and the contract is concluded on the basis of the tender selected by the purchaser in formal tender procedures. The participants in such procedures (i.e. the purchaser and the tenderers) are subject to certain legal obligations and liabilities. Under the second approach, the purchaser negotiates the contract in its entirety with enterprises selected by him without formal tender procedures. Participants in negotiation procedures are not subject to many of the obligations and liabilities to which participants in tender procedures are subject. Under the tender approach, the purchaser may choose the open tendering system, under which all interested enterprises are invited to submit tenders for the construction of the works. Alternatively, the purchaser may prefer the limited tendering system, under which only certain enterprises are invited by the purchaser to submit tenders (paragraphs 1 to 8).

Under a variant of the open tendering system, the opportunity to submit tenders may be restricted to enterprises which have been pre-qualified by the purchaser in accordance with pre-qualification procedures. Under these procedures, the purchaser should advertise internationally an invitation to apply for pre-qualification. Enterprises applying to be pre-qualified may be required to complete a questionnaire which seeks to elicit relevant information about the enterprise. The replies to questionnaires submitted by enterprises should be evaluated by the purchaser in accordance with criteria for pre-qualification which have been established by the purchaser. The purchaser should send all enterprises which have been pre-qualified notices informing them of their pre-qualification and inviting them to submit tenders, together with a full set of documents to be provided to prospective tenderers (paragraphs 5 and 9-13).

Under the tendering approach, an invitation to tender should be communicated to enterprises whose tenders are solicited. Under the open tendering system, the invitation should be communicated by means of an international advertisement. Under the limited tendering system, the invitation to tender should be individually sent to enterprises selected by the

purchaser, accompanied by a full set of documents to be provided to prospective tenderers (paragraphs 14 to 16).

The documents to be provided to prospective tenderers usually include, *inter alia*, instructions to tenderers conveying information with respect to the preparation, contents, submission and evaluation of tenders; draft forms of the documents which are to be submitted by the tenderer with his tender (e.g. tender guarantee and tender); and a document containing contractual terms. The instructions should specify that by submitting a tender a tenderer agrees to conform to and be bound by all the requirements, terms and conditions set forth in the instructions. The draft form of tender should also contain an express undertaking to the same effect (paragraphs 17 to 24).

The most common method of opening tenders is public opening, although private opening may be justified by exceptional circumstances. After tenders are opened, they should be compared and evaluated with a view to identifying the tender which complies with the purchaser's requirements and is most acceptable to him. The evaluation process usually takes place in certain stages: preliminary screening, detailed evaluation, discussions with the most acceptable tenderer, post-qualification and selection of the successful tenderer (paragraphs 25 to 34).

Under the negotiation approach, the contractor contacts a certain number of enterprises which he judges to be capable of constructing the works, informs them of his requirements, and requests offers. Documents describing the scope and quality of the construction and containing the contractual terms required by the purchaser may be submitted to the enterprises. No formalities are prescribed for making or evaluating the offers, or for negotiating the contract (paragraphs 35 and 36).

Even if the law governing the formation of the contract does not require the contract to be in written form, the parties should reduce their agreement to writing. The contract should identify the written documents which constitute the contract and should provide that no other documents and no oral statements form part of the contract. The contract should also provide that it may be modified or terminated only by agreement in writing. In some cases, the parties may wish to agree that contractual obligations are to arise only as from the date when a specified condition is fulfilled within a period of time set forth in the contract (paragraphs 37 and 38).

* * *

A. General remarks

1. There are in practice two basic approaches to the conclusion of a works contract. Under the first approach, the purchaser invites tenders from enterprises to construct the works, and the contract is concluded on the basis of the tender selected by the purchaser in formal tender procedures. Tenders submitted by

enterprises are usually based upon contractual terms and technical factors required by the purchaser, although certain details may be open to discussion by the purchaser and the enterprise (see paras. 24 and 32, below). One aspect of the formality of tender procedures is that the participants in such procedures (i.e. the purchaser and the tenderers) are subject to certain legal obligations and liabilities, e.g. with respect to the submission, withdrawal and selection of tenders (see paras. 19 to 22, below). Under the second approach, the purchaser negotiates the contract in its entirety with enterprises selected by him without formal tender procedures. Participants in negotiation procedures are not subject to many of the obligations and liabilities to which participants in tender procedures are subject.

2. Under the tender approach, the purchaser may choose the open tendering system, under which all interested enterprises are invited, by means of an internationally advertised notice, to submit tenders for the construction of the works. Alternatively, the purchaser may prefer the limited tendering system, under which only certain enterprises are invited by the purchaser to submit tenders. It should be noted that tender procedures may be regulated by mandatory rules of law in some countries, particularly when the purchaser is a public entity.

3. One advantage of the open tendering system is that it enables a broader range of enterprises to compete in tendering for the construction of the works. The purchaser will usually benefit from greater competition among enterprises with respect to the price, the design, and other factors relevant to the construction of the works. However, even under this system, there may exist certain limitations with respect to the enterprises which are permitted to participate in tendering. For example, some international financing institutions may require that preference be given to local or regional enterprises.

4. A disadvantage of the open tendering system is that it is the most complex, formal and costly of the procedures for the conclusion of a works contract. This procedure involves the preparation of formal tender documents, international advertisement of the invitation to bid, public opening of tenders and evaluation of all tenders submitted, which in some projects may be numerous. It also requires strict adherence to time-limits and other procedural requirements. In addition, the open tendering system sometimes attracts tenders from unqualified enterprises who submit low tenders of a speculative character. The purchaser has the task of investigating and eliminating such tenders. Correspondingly, qualified and reputable enterprises are sometimes unwilling to submit tenders when tendering is open to all enterprises.

5. Under a variant of the open tendering system, the opportunity to submit tenders may be restricted to enterprises which have been pre-qualified by the purchaser in accordance with pre-qualification procedures (see paras. 9 to 13, below). Under this technique, all

interested enterprises worldwide are given an opportunity to pre-qualify, and enterprises who are pre-qualified are entitled to submit tenders for the construction of the works. This technique enables the purchaser to limit participation in tendering to qualified enterprises. It also may enable the purchaser to assess, prior to the commencement of tendering procedures, the degree of interest in the project by enterprises.

6. The limited tendering system affords the advantage of some competition among tendering enterprises, although the extent of such competition is usually less than under the open tendering system due to the limited number of enterprises which are accorded the opportunity to submit tenders. Furthermore, to the extent that the purchaser has discussed the scope and quality of the works to be constructed with potential tendering enterprises, the documents to be provided to prospective tenderers (see para. 17, below) may be simplified as compared with those required under the open tendering system. The limited tendering system also has the advantage of confining the tender process to enterprises which the purchaser considers to be qualified and reputable. However, the limited tendering system also entails certain formalities, although these may be somewhat less than under the open tendering system. For example, under the limited tendering system the invitation to tender is delivered to enterprises selected by the purchaser; advertisement of the invitation is not necessary. It should be noted that international financing institutions might not permit the use of the limited tendering system in some cases. This system may be suitable where the technology to be incorporated in the works can be supplied, or the construction can be effected, only by a limited number of enterprises.

7. Negotiation of the works contract with potential contractors avoids the formalities of the tender approach. Under the negotiation approach, the purchaser need not prepare documents to be provided to prospective tenderers (see para. 17, below), although it will usually be advantageous for him to draft certain documents to serve as the basis for negotiations (see para. 35, below). Under this approach, however, the purchaser does not benefit to the same degree as under the tendering approach from competition among several enterprises with respect to the price, design and other factors in relation to the works.

8. The use of the negotiation approach may be appropriate where one potential contractor has a satisfactory record of constructing works similar to the works to be constructed for the purchaser, and where no further advantages are to be gained by inviting tenders from other enterprises. The approach may also be appropriate where the equipment or technology to be included in the works may be obtained only from one or a limited number of enterprises. It may also be appropriate where the envisaged construction is to extend the capacity of, or modernize, existing works and such construction must, therefore, conform to the existing technological process or equipment; in some cases, only the contractor who constructed the existing

works may be able to perform the required new construction. In exceptional cases, the need for early completion of the works may also justify engaging a contractor without prior tendering, as tendering would in most cases require more time for the conclusion of a contract than would the negotiation approach.

B. Tendering

1. Pre-qualification

9. Pre-qualification of potential tendering enterprises is sometimes resorted to under the open tendering system (see para. 5, above). Pre-qualification should be based upon the ability of the enterprise to construct the works as required by the purchaser. It may be noted in this connection that international financing institutions may prohibit a purchaser from denying pre-qualification to an enterprise for reasons unrelated to the ability of the enterprise to construct the works. In assessing an enterprise's ability to construct the works, the purchaser should consider the enterprise's experience and past record of performance, its capability of supplying the necessary technology, equipment, materials and services, and its financial status.

10. The first step in the pre-qualification process should be the international advertisement of an invitation to apply for pre-qualification. The factors to be considered with respect to the advertisement should be similar to those to be considered with respect to the advertisement of an invitation to tender (see paras. 15 and 16, below). The invitation to apply for pre-qualification should contain the following information:

Information concerning the purchaser;

A brief description of the location, nature and size of the works to be constructed;

The expected time for completion of construction;

The address at which the pre-qualification questionnaire (see following paragraph) may be obtained;

The date for submission of replies to the pre-qualification questionnaire.

11. In order to enable the purchaser to make a well-considered judgement on whether to pre-qualify an enterprise, it is desirable that the purchaser require enterprises applying to be pre-qualified to complete a questionnaire which seeks to elicit relevant information about the enterprise. Such a questionnaire should be sent by the purchaser to enterprises applying to be pre-qualified and should elicit, in particular, the following information:

A description of the enterprise, its structure and organization, and its length of experience as a contractor;

A certified financial statement showing the assets and liabilities of the enterprise; its volume of business in the previous five years; its working capital; bankers' references;

The numbers and categories of supervisory staff and key personnel proposed to be employed for the construction of the works and their experience in construction of industrial works;

The source and nature of the main items of machinery and tools proposed to be used in the construction;

A list of projects of comparable size and complexity which the enterprise has completed in the previous five years; the identities of the purchasers and the consulting engineers in those projects; the final contract price and the final costs for each of those projects; if the final contract price for a project was higher than the original contract price, the reasons therefor; whether each project was completed satisfactorily; similar information on the record of performance of the principal sub-contractors proposed to be employed in the construction of the works;

Whether the enterprise has ever failed to complete work under a construction contract to which he was a party;

Existing and anticipated work commitments;

The nature and amount of existing insurance coverage.

12. The questionnaire sent to enterprises should be accompanied by instructions for its completion, including the language to be used in completing the questionnaire and the currency in which financial information is to be expressed.

13. The replies to questionnaires submitted by enterprises should be evaluated by the purchaser in accordance with criteria for pre-qualification which have been established by the purchaser. When the construction of the works is financed by an international financing institution, these criteria should be in accordance with any guidelines or requirements which may be set forth by the institution. After evaluating the replies to the questionnaire, the purchaser should notify unsuccessful enterprises that they have not been pre-qualified and should send all enterprises which have been pre-qualified notices informing them of their pre-qualification and inviting them to submit tenders. At the same time, the purchaser should send to enterprises which have been pre-qualified a full set of documents to be provided to prospective tenderers (see para. 17, below).

2. Invitation to tender

14. An invitation to tender should be communicated to enterprises whose tenders are solicited. Under the open tendering system, the invitation to tender should be communicated by means of an international advertisement. Under the limited tendering system, the invitation to tender should be individually sent to enterprises selected by the purchaser, accompanied by a full set of documents to be provided to prospective tenderers. The invitation to tender is often prepared by the purchaser's consulting engineer. It should contain the following information:

Information concerning the purchaser;

A brief description of the location, nature and size of the works to be constructed;

The expected time for completion of construction;

The address at which documents for prospective tenderers may be obtained;

The fee, if any, for the documents and the method of payment of such fee (the amount of the fee should normally cover the costs of producing and supplying the documents, yet should be at such a level as to discourage enterprises which are not genuinely interested in undertaking the construction from requesting the documents);

The date for submission of tender;

The amount of the tender guarantee, if any;

The source of financing for the construction of the works, and any eligibility criteria imposed by a financing institution.

15. When the invitation to tender is to be advertised, the advertisement should be designed so as to provide an opportunity to all potentially interested enterprises worldwide to participate in the tender procedures. With respect to the media in which the advertisement is to appear, the law of the purchaser's country may mandatorily require advertisement in certain media (e.g. the official gazette). The purchaser should also consider advertising in local newspapers, foreign newspapers circulated in the major commercial centres of the world, technical journals and trade publications. If the construction is being financed by an international financing institution, the purchaser should also comply with any advertisement requirements of the institution.

16. The invitation to tender should specify the time within which enterprises must prepare and submit their tenders to the purchaser. This time may depend upon the location of the site and the scope and complexity of the works to be constructed. In practice, purchasers often allow a period of between 45 and 90 days. This period of time may commence on the date of the invitation to tender. Alternatively, and in particular if the invitation to tender is advertised, the invitation to tender might specify a date by which tenders must be submitted to the purchaser. The timing of the submission of the advertisement to the various media should take into account the fact that different media may publish at different intervals (e.g. daily, monthly, quarterly), and the timing should be such that the advertisement is published at approximately the same time in all the media. All enterprises will then have approximately the same amount of time to obtain the documents to be provided to prospective tenderers and to prepare and deliver their tenders to the purchaser.

3. Documents to be provided to prospective tenderers

17. The documents to be provided to prospective tenderers are often prepared by the purchaser's consulting engineer. They usually consist of the following: instructions to tenderers (see paras. 18 to 22, below), contractual terms required by the purchaser (see para.

23, below), technical specifications, drawings, draft form of tender guarantee (see para. 20, below) and performance guarantee, draft form of tender (see para. 24, below), draft form of certificate of authority (certifying that persons signing the tender have the necessary authority to do so), schedules of supplementary information and such other documents as are appropriate. The provision of draft forms of the documents which are to be submitted by the tenderer with his tender will assist the purchaser in comparing and evaluating tenders. When there have been no pre-qualification procedures, the purchaser should also supply prospective tenderers with a questionnaire, similar to a pre-qualification questionnaire (see para. 11, above), which a tenderer should be required to submit with his tender. The documents should be made available in at least one language customarily used in international commercial transactions.

18. The instructions to tenderers should convey information with respect to the preparation, contents, submission and evaluation of tenders. With respect to the preparation of tenders, the instructions should list the documents which must be submitted with a tender (these should include all documents, duly executed, of which draft forms were provided to the tenderer (see para. 17, above)), and specify the language or languages to be used in completing these documents. They should also set forth any requirements of the purchaser as to how costs and the tender price are to be expressed. The instructions may, for example, specify the currency in which the costs and price are to be expressed, and may specify that portions of the price which are allocated to certain aspects of the construction must be shown separately. The instructions should indicate whether an enterprise may submit tenders with alternative terms and, if so, the item or items for which alternatives are acceptable (e.g. transportation arrangements, insurance schemes, or the design of less important equipment), and specify the number of copies of the tender documents to be submitted and the time within which or the date by which tenders must be submitted.

19. The instructions should also set forth the procedures for inspection of the site by enterprises, the method by which a prospective tenderer may seek clarification of the documents provided to him, and the period of time during which the tender must remain in effect. With respect to the last item, the purchaser should allow adequate time for the tenders to be evaluated and the successful tenderer to be selected and notified, for any discussions between the purchaser and the tenderer needed prior to the conclusion of the contract, and for the submission by the successful tenderer of the performance guarantee. The purchaser may consider a period of between 90 to 120 days after the deadline for submitting tenders to be appropriate. The purchaser might also reserve the right to extend this period, if necessary, by notifying all tenderers of the length of the extension. The instructions should provide that tenderers who agree to such an extension are required to extend their tender guarantees to cover the extended period, and that tenderers who do not so agree will be considered to have withdrawn their

tenders, but without forfeiting their tender guarantees. Tenderers should not be permitted to change the terms of their tenders during the period of extension.

20. The instructions should require that the tender be accompanied by a tender guarantee in a form and amount acceptable to the purchaser. The purchaser may wish to provide to prospective tenderers a draft form of tender guarantee which meets the requirements of the purchaser, as this will provide certainty that the terms which the purchaser requires will be contained in the guarantee submitted by the tenderer. The amount payable under a tender guarantee should be recoverable by the purchaser if the tenderer providing the guarantee withdraws his tender after the deadline for submitting tenders, or if his tender is selected by the purchaser and he fails to conclude a works contract with the purchaser in accordance with his tender or fails to provide a required performance guarantee. The guarantee should indicate whether the purchaser must prove that one of these events has occurred before he is entitled to recover the amount due, or whether a mere assertion by the purchaser that such an event has occurred is sufficient. The guarantee should also indicate whether the amount due is recoverable without proof of loss by the purchaser, or whether the purchaser must prove the loss sustained by him (see the chapter "Security for performance"). The amount of the tender guarantee should be high enough to constitute an adequate deterrence to the tenderer from withdrawing his tender after the deadline for submitting tenders, and to compensate the purchaser for any loss he may suffer from the failure of the tenderer to conclude a works contract in accordance with his tender or submit a performance guarantee (e.g. the costs of engaging in new tender procedures and the difference between the withdrawing or defaulting tenderer's price and a higher price in a tender selected by the purchaser in new tender procedures). Such amount may be set forth as a specific amount or as a percentage of the tender price. The draft form of tender guarantee should provide that it is to remain in effect during the period of time when the tender is to remain in effect. If a draft form of tender guarantee is not provided to prospective tenderers, the instructions should set forth the requirements of the purchaser regarding the tender guarantee. In addition to specifying the required amount of the guarantee, the conditions under which it is recoverable by the purchaser, and the period of time during which it is to remain in effect, the instructions should specify the currency in which the guarantee is to be furnished. They should also specify the acceptable type or types of tender guarantee. Possible types may include a standby letter of credit, a bank guarantee, or a guarantee issued by an insurance or bonding company. Where the guarantee may be issued by a financial institution, the purchaser may wish to specify the institutions acceptable to him (see, also, the chapter "Security for performance").

21. The instructions should set forth applicable procedures for dealing with discrepancies in the various documents provided by the purchaser to prospective tenderers and should specify whether and when tenders may be modified. The instructions should state that

tenders cannot be modified or withdrawn after the deadline for submitting tenders. However, inadvertent or insignificant errors in tenders might be permitted to be rectified in some cases (see, also, para. 30, below). In addition, the instructions should set forth the general criteria by which the purchaser will evaluate the tenders (e.g. the weight to be given to the tender price (see para. 31, below)). They may also specify that the purchaser reserves the right not to select any tender. They should indicate procedures according to which the tenders will be opened and tenderers will be notified of the outcome of the evaluation of tenders, and the procedure for concluding the contract.

22. Finally, the instructions should set forth any other requirements of the purchaser. For example, the purchaser may wish to set forth a requirement that a tenderer who has been pre-qualified should update the information given in his pre-qualification questionnaire, a requirement that costs associated with the preparation and submission of tenders are to be borne by the tenderer, a requirement that all documents submitted with the tender are to be typed or written in indelible ink, a requirement that all signatures must be those of persons who are authorized under certificates of authority submitted with the tender to sign the tender or are authorized to sign on behalf of the tenderer, and a requirement that all erasures to documents must be signed or initialed by the persons signing the documents. The instructions should specify that by submitting a tender a tenderer agrees to conform to and be bound by all the requirements, terms and conditions set forth in the instructions.

23. It is desirable for the contractual terms to be drafted by the purchaser and supplied to prospective tenderers with the other documents described above (see para. 17) and for the instructions to require that the tender be based upon such contractual terms. Unless this is done, it will be difficult for the purchaser to compare and evaluate tenders, as each tenderer may submit his tender on the basis of differing contractual terms. Under the tender approach, such terms are usually not the subject of negotiations between the parties (although the purchaser may allow certain details to be discussed); rather, in determining his tender price the tenderer will take into account such terms and the allocation of costs, risks and liabilities reflected therein. The various issues which should be addressed in the contractual terms, and the ways in which these issues may be treated, are discussed in part two of this Guide.

24. The draft form of tender should set forth the offer of the tenderer to construct the works in accordance with the contractual terms, technical specifications and drawings provided to the tenderer. It should also call upon the tenderer to set forth his offer as to the matters in respect of which the tenderer's offer is solicited (e.g. price, payment conditions). The draft form of tender should also expressly state that the tenderer undertakes to conform to and be bound by all terms and conditions set forth in the instructions to tenderers.

4. *Opening and evaluation of tenders*

(a) *Opening of tenders*

25. The most common method of opening tenders is public opening, i.e. opening in the presence of tenderers or their representatives. If the purchaser so wishes, even persons who have not tendered may be permitted to be present. Public tender opening may be required by financing institutions, as this tends to reduce abuses in the selection of the successful tenderer.

26. The instructions to tenderers may have required the submission of tenders under the two-envelope system. Under this system, tenderers submit two envelopes, one containing the technical elements of their tender, but without mention of a price, and the other containing the price. If the two-envelope system for the submission of tenders has been adopted, the envelopes containing the technical elements are first opened in private and the technical elements evaluated to determine whether they comply with the purchaser's requirements. Thereafter the envelopes containing the tender prices submitted by those tenderers who have submitted technical elements complying with the purchaser's requirements are opened at a public session, and these tenders are later evaluated in greater detail. This procedure may lead to a more objective evaluation of technical elements because these elements are evaluated without a consideration of the associated price.

27. The opening of tenders is sometimes conducted in private, without tenderers being present. Such a procedure may be justified by exceptional circumstances (e.g. when the works to be constructed is related to national security). Private opening of tenders may also result in a more realistic evaluation of tenders. However, this procedure may lead to abuses, and accordingly it is not permitted by many financing institutions. If this procedure is to be adopted, however, the confidence of the tenderers in the proceedings, and the participation in the opening of individuals of recognized integrity (auditors or senior civil servants).

(b) *Evaluation of tenders*

28. The purpose of tender evaluation is to compare the tenders with a view to identifying the tender which complies with the purchaser's requirements and is most acceptable to him, taking into account all relevant factors. The evaluation procedure, unlike the opening of tenders, should be conducted without the tenderers being present. The purchaser may seek any clarification needed to evaluate a tender during the evaluation period. The evaluation process usually takes place in certain stages: preliminary screening, detailed evaluation, discussions with the most acceptable tenderer, and post-qualification and selection of the successful tenderer.

(i) *Preliminary screening*

29. A preliminary screening should be used to determine whether the tender complies with the purchaser's requirements as to the tender and the documents which

should accompany the tender (see para. 18, above). This may involve checking the following items:

Whether the tender has been signed by an authorized representative of the tenderer;

Whether the tenderer has met any eligibility requirements, e.g. whether he is on the pre-qualified list if pre-qualification procedures were used, or whether he meets requirements laid down by the financing institution, if any;

Whether the tender substantially complies with the contractual terms and technical requirements set out in the invitation to tender and the instructions to tenderers;

Whether the full set of required documents has been submitted.

30. The documents may also be checked for arithmetical or clerical errors at the stage of screening. The process of screening may enable the purchaser to place the tenders in different categories. Certain tenders will contain substantial deviations from the requirements of the purchaser and need no longer be considered. Certain tenders may contain deviations which appear to be inadvertent (e.g. omission of required documents). In such cases, the purchaser may wish to contact the tenderer to inquire whether he wishes to rectify the deviation. Yet other tenders may contain minor deviations which have to be assessed in financial terms at the stage when a detailed evaluation is made of the tenders.

(ii) *Detailed evaluation*

31. The general criteria to be considered in the detailed evaluation of tenders would have been set forth in the instructions to tenderers (see para. 21, above). The tender with the lowest price need not necessarily be the most acceptable, although the tender price is one of the most important criteria to be considered. In the detailed evaluation, any deviations, qualifications or alternatives set forth by the tenderer must be evaluated in terms of their direct and indirect costs and benefits to the purchaser in order to arrive at the most acceptable tender. An important criterion would be the technical aspects of the tender (e.g. conformity with specifications and drawings supplied by the purchaser, and proposed methods of construction). The past record of the tenderer, and the nature of on-going projects undertaken by him, should also be carefully considered. Where margins of preference are applicable in the selection of tenderers, these margins should be calculated in relation to the tenderers eligible for the benefit of such margins. Depending on the nature of the contract, a further variety of criteria (e.g. extent of transfer of technology to the purchaser, nature of the skilled personnel allocated to the performance of the contract, extent to which work is to be sub-contracted) should be assessed.

5. *Discussions with most acceptable tenderer*

32. There will probably be items in the tender of the most acceptable tenderer, e.g. minor deviations from

the purchaser's design or certain contractual terms, which must be discussed and resolved to the satisfaction of the purchaser before a contract can be concluded (see para. 30, above).

6. *Post-qualification and selection of successful tenderer*

33. Once discussions are successfully concluded with the most acceptable tenderer, the purchaser must determine if this tenderer is capable of performing the contract. If a pre-qualification procedure has been used or a questionnaire as to his qualifications has been completed by the tenderer, the purchaser need only make certain that the tenderer's ability to perform has not been affected between the time of pre-qualification or the completion of the questionnaire and the time of the decision to select him. If these procedures have not been used, the purchaser may wish to require the tenderer to complete a questionnaire such as the one described in relation to pre-qualification (see para. 11, above).

34. The successful tenderer should be notified of his selection and required to furnish the performance guarantees. Immediately after the successful tenderer has concluded a contract and has furnished security for performance, the tender guarantees of unsuccessful tenderers should be returned.

C. *Negotiation*

35. Under this approach, the contractor contacts a certain number of enterprises which he judges to be capable of constructing the works, informs them of his requirements, and requests offers. Documents describing the scope and quality of the construction and containing the contractual terms required by the purchaser may be submitted to the enterprises. No formalities are prescribed for making or evaluating the offers or for negotiating the contract. In some cases, at the outset of the negotiations, the parties may wish to agree that certain types of information (e.g. technological processes) disclosed by a party during the course of the negotiations are to be kept confidential by the other party.

36. The purchaser should clearly define the extent of authority of the team negotiating on his behalf and communicate such extent to the contractors with whom negotiations are commenced. It may be useful to keep a record of the progress of the negotiations which should be authenticated on behalf of each party as the negotiation progresses.

D. *Conclusion of contract*

1. *Form of contract*

37. Whether the tendering approach or the negotiation approach has been adopted, the law governing the formation of the contract may require a works contract to be in the written form. Even if such law does not require the written form, the parties should reduce their agreement to writing in order to avoid disputes as to what terms were agreed upon. The contract should identify the written documents which constitute the contract and should provide that no other documents and no oral statements form part of the contract. The contract should also provide that it may be modified or terminated only by agreement in writing.

2. *Validity and entry into force of contract*

38. In negotiating and concluding the contract, the parties should take account of the legal rules governing the formation and validity of the contract. Some of these rules may have a mandatory character. Contractual obligations between the parties would usually arise as from the date of the conclusion of the contract. In some cases, however (e.g. where one party must obtain a licence without which performance of the contract is impossible), the parties may wish to agree that contractual obligations are to arise only as from the date when a specified condition is fulfilled, provided such condition is fulfilled within a period of time set forth in the contract. When the negotiation procedure is adopted, in order to identify clearly the point of time at which the contract is concluded, the purchaser may wish to stipulate at the commencement of negotiations that no contractual obligations between the parties are to arise until the parties have agreed in writing that a contract has been concluded between them.

C. *Further work of the Commission in the area of international contracts for construction of industrial works: note by the secretariat (A/CN.9/268)**

1. The Commission will have before it at this session the reports of the Working Group on the New International Economic Order on the work of its sixth and seventh sessions (A/CN.9/259 and A/CN.9/262). Considerable progress has been made by the Working Group in its work on the preparation of a draft Legal Guide on drawing up international contracts for the

construction of industrial works, and it is expected that the final instalment of the draft chapters of the Legal Guide will be considered at the eighth session of the Working Group in the first quarter of 1986. Thereafter, only the revision of the draft chapters by the secretariat, and the overall consideration of these revised chapters, will be necessary to complete the work. The secretariat has accordingly been giving consideration to enhancing the value of the Legal Guide by the preparation of annexes to the Legal Guide dealing with areas which

*For consideration by the Commission, see *Report*, chapter IV (part one, A, above).

are closely related to the construction of industrial works, and some suggestions for continued work have already been made at past sessions of the Commission and the Working Group.

2. In this connection, the Commission may wish to note that the Asian-African Legal Consultative Committee (AALCC) at its recent session (Kathmandu, Nepal, 6-13 February 1985) reviewed the work of the Commission relating to the new international economic order. After expressing its satisfaction and appreciation of the progress which had thus far been made in the preparation of the Legal Guide, the AALCC made the following recommendations:

"that UNCITRAL should consider the preparation of an annex to the Legal Guide, dealing with legal issues related to joint ventures arising in the context of industrial contracts, in view of the practical and legal difficulties that may arise out of these arrangements, particularly for parties in developing countries;

"that UNCITRAL consider taking up concession agreements and other agreements in the field of natural resources in the near future, as that topic had gained a certain urgency for the developing countries on account of the shift in the pattern of mineral exploration from developing to developed countries."

3. The secretariat is currently examining these suggestions. As regards concession and other agreements, in particular in the field of mineral resources, the Commission may wish to note that several international bodies are already rendering assistance to developing countries. These bodies include the United Nations Department of Technical Co-operation for Development, the United Nations Centre on Transnational Corporations, the United Nations Industrial Devel-

opment Organization (UNIDO), and the World Bank. The work undertaken by these bodies covers legal areas (e.g. the assessment and preparation of legislation for investment and taxation, drafting and assistance in the negotiation of contracts, and the re-negotiation of contracts). The undertaking of work by the Commission in the area may therefore lead to the duplication of activity. As regards joint ventures, where the operations of a joint venture included the construction of industrial works, it would have to be carefully assessed in the light of work done on joint ventures by other international bodies, including UNIDO, whether the legal issues which arise in relation to the construction are of such a scope as to justify an annex to the Legal Guide. Possibilities may also be explored, however, whether some useful well-defined legal work might be undertaken combining the two recommendations of the AALCC.

4. Preliminary consideration has also been given to the preparation of an annex dealing with the area of tendering and procurement in relation to the construction of industrial works. The work undertaken by the secretariat in the preparation of the draft chapter of the Legal Guide on the procedure for concluding a contract suggests that further investigation of this area is justified, and that a more detailed examination than is possible in the draft chapter of the issues involved may be a valuable supplement to the Legal Guide. However, further research needs to be done to ascertain the feasibility and advisability of work, and to formulate concrete proposals.

5. The Commission may therefore wish to note the intention of its secretariat to submit to a future session of the Commission a report setting forth proposals on how the value of the Legal Guide may further be enhanced.

IV. OPERATORS OF TRANSPORT TERMINALS

Eighth session of the Working Group on International Contract Practices

A. Report of the Working Group on International Contract Practices on the work of its eighth session (Vienna, 3-13 December 1984) (A/CN.9/260)^a

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Introduction

1. At its sixteenth session, the Commission decided to include the topic of liability of operators of

transport terminals in its programme of work, to request the International Institute for the Unification of Private Law (UNIDROIT) to transmit its preliminary draft Convention on this topic to the Commission for its consideration, and to assign work on the preparation of Uniform Rules on this topic to a working group. The Commission deferred to its

^aFor consideration by the Commission, see *Report*, chapter V (part one, A, above).

seventeenth session the decision on the composition of the Working Group.¹

2. In response to the request at the sixteenth session, UNIDROIT transmitted its preliminary draft Convention to the Commission. At its seventeenth session, the Commission decided to assign to the Working Group on International Contract Practices the task of formulating Uniform Legal Rules on the subject. It further decided that the mandate of the Working Group should be to base its work on the UNIDROIT preliminary draft Convention and the Explanatory Report thereto prepared by the secretariat of UNIDROIT, and on the study of the UNCITRAL secretariat on major issues arising from the UNIDROIT preliminary draft Convention, which was before the Commission at its seventeenth session (A/CN.9/252), and that the Working Group should also consider issues not dealt with in the UNIDROIT preliminary draft Convention, as well as any other issues which it considered to be relevant.²

3. The Working Group consists of all 36 States members of the Commission: Algeria, Australia, Austria, Brazil, Central African Republic, China, Cuba, Cyprus, Czechoslovakia, Egypt, France, German Democratic Republic, Germany, Federal Republic of, Guatemala, Hungary, India, Iraq, Italy, Japan, Kenya, Mexico, Nigeria, Peru, Philippines, Senegal, Sierra Leone, Singapore, Spain, Sweden, Trinidad and Tobago, Uganda, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United Republic of Tanzania, United States of America and Yugoslavia.

4. The Working Group held its eighth session at Vienna from 3 to 13 December 1984. All members were represented except Central African Republic, Cyprus, Czechoslovakia, Senegal, Sierra Leone, Singapore, Trinidad and Tobago, Uganda and United Republic of Tanzania.

5. The session was attended by observers from the following States: Argentina, Canada, Chile, Côte d'Ivoire, Ecuador, Holy See, Indonesia, Iran (Islamic Republic of), Netherlands, Nicaragua, Norway, Oman, Republic of Korea, Romania, Switzerland and Turkey.

6. The session was also attended by observers from the following international organizations:

(a) *United Nations organs*

United Nations Conference on Trade and Development

United Nations Industrial Development Organization

(b) *Intergovernmental organizations*

Commission centrale pour la navigation du Rhin

International Air Transport Association

Office central des transports internationaux par chemin de fer

International Institute for the Unification of Private Law

(c) *International non-governmental organizations*

International Association of Ports and Harbors

International Federation of Freight Forwarders Associations

International Law Association

7. The Working Group elected the following officers:

Chairman: Michael Joachim Bonell (Italy)

Rapporteur: K. Venkatramiah (India)

8. The following documents were placed before the session:

"Provisional agenda" (A/CN.9/WG.II/WP.51);

"Liability of operators of transport terminals: issues for discussion by the Working Group: note by the secretariat" (A/CN.9/WG.II/WP.52 and Add.1);

"Liability of operators of transport terminals: additional issues for discussion by the Working Group: note by the secretariat" (A/CN.9/WG.II/WP.53).³

9. The following documents were also made available at the session:

"Co-ordination of work: some recent developments in the field of international transport of goods" (A/CN.9/236);

"Liability of operators of transport terminals" (A/CN.9/252);

Preliminary draft Convention on Operators of Transport Terminals⁴ and the Explanatory Report thereto⁵ (UNIDROIT document 1983, Study XLIV-Doc. 24).

10. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Formulation of Uniform Legal Rules on the liability of operators of transport terminals.
4. Other business.
5. Adoption of the report.

Deliberations and decisions

I. Method of work

11. The Working Group commenced its deliberations by discussing its method of work for carrying out the

¹Report of the United Nations Commission on International Trade Law on the work of its sixteenth session, *Official Records of the General Assembly, Thirty-eighth Session, Supplement No. 17* (A/38/17), para. 115.

²Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 113.

³Issued during the course of the session.

⁴Also reproduced in annex II of A/CN.9/252.

⁵Also reproduced in A/CN.9/WG.II/WP.52/Add.1.

task of preparing Uniform Rules on the liability of operators of transport terminals (hereinafter referred to as OTTs). It was generally agreed that, in conformity with the mandate given to it by the Commission (see para. 2), the Working Group should base its work on the UNIDROIT preliminary draft Convention and on the Explanatory Report thereto as well as on document A/CN.9/252. In addition, it was agreed that the Working Group should be free to consider issues which were not dealt with in the preliminary draft Convention. The view was expressed that the objective of the Working Group in this project should be to fill in the gaps in the liability régimes governing the international transport of goods by unifying the Legal Rules governing the operations of terminal operators, and to build upon the work already performed in this area by UNIDROIT. It was noted at the same time that such Rules could also have great importance of their own, regulating relations which, though connected with the field of transportation, were legally quite distinct from relations arising from the contract of carriage.

12. It was agreed that the Working Group should engage in a comprehensive consideration of the issues arising in connection with the liability of OTTs before it attempted to draft detailed Uniform Rules. In this regard, it was agreed that the working papers prepared by the UNCITRAL secretariat on issues for discussion by the Working Group (A/CN.9/WG.II/WP.52 and A/CN.9/WG.II/WP.53) provided a useful basis for these discussions. Accordingly, the Working Group decided to base its discussions on the issues set forth in those documents.

13. The Working Group considered whether it would be appropriate at this stage of the work to decide upon the ultimate form in which the Rules should be cast. According to one view, it might be useful to decide this issue at the outset of the work in the Working Group since it might have some influence in the discussions on a point of substance. The prevailing view, however, was that the form of the Rules could best be decided after the Working Group had established the substance and content of the Rules. In accordance with this view, the Working Group was agreed that the discussions should proceed under the assumption that the Uniform Rules would have a normative character (e.g. a convention or a model law) rather than a contractual character (e.g. general contract conditions).

II. Consideration of issues possibly to be dealt with in the uniform rules

A. Scope of application of Uniform Rules

1. Relationship of Uniform Rules to international transport

14. The Working Group considered whether the Uniform Rules should deal only with operations of OTTs related to international transport (issue 1, A/CN.9/WG.II/WP.52). The prevailing view was that since the objective of the Uniform Rules was to fill gaps

in the liability régimes left by international transport conventions, the Uniform Rules should deal only with operations of an OTT related to international transport. According to this view, operations of OTTs which were not related to international transport were of a domestic rather than of an international nature and there was no need to unify the Legal Rules governing such operations. It was observed, however, that States wishing to do so could apply the Rules also to domestic operations of OTTs, and that OTTs performing domestic operations could contractually subject themselves to these Rules. According to another view, all operations of OTTs, whether domestic or international, should be governed by the Uniform Rules, since an OTT might not be able to determine whether or not the goods were involved in international transport.

15. A view was expressed that even if the Rules were to be limited to operations related to international transport, due to the different factual circumstances in which OTTs operated the mandatory application of the Rules to all cases of safekeeping of goods related to international transport might not be warranted. According to this view, it might be useful to make the Uniform Rules subject to an opting-in provision, i.e. that the Rules would apply only in respect of those OTTs who had undertaken to be bound by the Rules. The prevailing view, however, was that the question of mandatory or conditionally mandatory application of the Uniform Rules was closely linked to the ultimate form which the Rules should take and that, in view of the decision previously taken (see paragraph 13), the decision on this question should be left to a later stage.

16. A suggestion was made that, in cases where the transport of goods was performed by a multimodal transport operator under the United Nations Convention on International Multimodal Transport of Goods (1980) (hereinafter referred to as the Multimodal Convention), there was no need for rules on OTT operations, since the cargo interest would have a claim against the multimodal transport operator for loss of or damage to the goods while in the hands of an OTT. However, it was pointed out that even in such cases the Uniform Rules would be useful by providing to the multimodal transport operator a unified recourse action against the OTT.

17. The Working Group discussed the way in which the Uniform Rules should define the required relationship with international transport (issues 2-4, A/CN.9/WG.II/WP.52). It discussed two basic approaches in this regard. Under one approach (the "objective approach"), the Uniform Rules would apply if the goods in fact had been, were being or were to be carried in international transport. Under the other approach (the "subjective approach"), the Rules would apply if the OTT knew or should have known of such a link with international transport.

18. In support of the objective approach, it was suggested that it would be difficult to prove the knowledge of such a link by the OTT. Moreover, such an approach would be consistent with the approach

adopted in the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg)⁶ (hereinafter referred to as the Hamburg Rules) and the Multimodal Convention. A suggestion was made, however, that the Uniform Rules might contain an "escape clause" whereby the OTT would be able to prove that he had no knowledge of such a link, in which case the Uniform Rules would not apply. It was suggested that in most cases an OTT would be able to determine the existence of a link with international transport from the documents accompanying the goods, since such documents would show the places of origin and destination of the goods.

19. In support of the subjective approach, a view was expressed that for the Uniform Rules to apply it should be sufficient if it were apparent from the documents accompanying the goods that the goods were involved in international transport. It was also observed that, if the Uniform Rules were to require a document to be issued by the OTT, the OTT would have to become aware of a link with international transport in order to know whether he was obligated to issue a document conforming to the Uniform Rules. According to an additional view, an OTT could be made aware of a link with international transport by being notified thereof by his customer. A suggestion was also made that the application of the Uniform Rules could be based upon a combination of the objective and subjective approaches.

20. The prevailing view favoured an objective approach, bearing in mind that the drafting of such an approach should result in the application of the Uniform Rules to operations of OTTs in connection with international transport, rather than to domestic operations. Questions were raised as to whether the Uniform Rules should apply when goods were deposited with an OTT prior to the commencement of transport or after transport had ended, for example when the goods were to be further distributed domestically. Support was expressed for a formulation such as that contained in alternative (a) in the remarks to issue 3 in document A/CN.9/WG.II/WP.52 (i.e. that the Uniform Rules are to apply to operations of an OTT which are related to carriage in which the place of departure and the place of destination are situated in two different States). It was considered that such a formulation offered the simplest and most acceptable solution, although a view was expressed that the words "related to" might give rise to some uncertainty and should be re-examined. Views were also expressed in support of the formulation contained in alternative (b) in the remarks to issue 3, although it was suggested that this formulation excluded the case in which goods destined for international transport were delivered by the shipper to an OTT, rather than to a carrier. With respect to alternative (c) a view was expressed that this alternative was unacceptable because the time at which the goods became subject to or ceased to be subject to Legal Rules governing

international transport was in many cases uncertain, and because such a formulation would require research by the OTT into whether this had occurred.

21. A suggestion was made that it might be sufficient to provide that the Uniform Rules were to apply to operations performed before, during or after carriage of the goods, when such operations were related to carriage in which the place of departure and place of destination were situated in two different States.

2. *Types of operators and operations to be governed by Uniform Rules*

22. The Working Group considered the types of operators and operations to be governed by the Uniform Rules (issues 5 and 6, A/CN.9/WG.II/WP.52). It was observed that there existed wide variations with respect to the types of operations performed by OTTs. In addition to safe-keeping, OTTs often performed other operations in relation to the goods. It was generally agreed that the scope of application of the Uniform Rules should clearly set forth the types of operations which were to be governed by the Rules.

23. According to one view, the Uniform Rules should apply to all operations performed by OTTs, whether or not such operations related to the safekeeping of the goods. The prevailing view, however, was that the Rules should apply only when safe-keeping was included. A question was raised as to whether safe-keeping performed without remuneration should be governed by the Uniform Rules.

24. It was suggested that the Rules might apply to operations performed by an OTT in addition to safe-keeping. According to one view, the Rules should apply only where safe-keeping was the primary operation to be performed and should also apply to ancillary operations. According to another view, the application of the Rules should not be based upon such a relationship, which was difficult to define in concrete cases; rather, the Rules should apply whenever safe-keeping constituted a distinct and intrinsic part of the obligation of the OTT.

25. Various views were expressed concerning the question of which operations in addition to safe-keeping should be governed by the Uniform Rules. According to one view, all additional operations performed by an OTT should be governed by the Rules. In support of this view, it was stated that such an approach would completely fill the gaps in the legal régime governing the transport of goods. According to another view, however, it would not be appropriate to subject the wide variety of such additional operations to a single unified legal régime to be established by the Uniform Rules. In this connection, it was observed that, although it was not possible to fill all such gaps by a single legal régime, a substantial contribution would be made if the Uniform Rules governed safe-keeping as well as certain types of additional operations.

⁶Official Records of the United Nations Conference on the Carriage of Goods by Sea (United Nations publication, Sales No. E.80.VIII.1), part 1, Final Act of the United Nations Conference on the Carriage of Goods by Sea (A/CONF.89/13), annexes I and II.

26. With respect to how the Uniform Rules should delimit the types of additional operations to be covered, one approach suggested was that the Rules might contain an exhaustive itemization of such operations, such as loading, unloading and stowage. According to another view, however, the Uniform Rules should only list examples of the types of such additional operations to be covered. Questions were raised as to whether the Uniform Rules should govern operations such as pick-up and delivery, packaging and processing of goods.

27. The Working Group agreed that it was not yet prepared to reach final conclusions as to the types of operations to be governed by the Uniform Rules, and that it would have occasion to return to a consideration of this issue at a future time. In this connection, a request was made that the secretariat prepare a further study for the Working Group on various aspects of the issue, taking into account operations performed as well as circumstances relating to various modes of transport. It was also requested that the study consider legal aspects of the issue arising from various international transport conventions, including the points of time at which a carrier's responsibility for the goods began and ended, which could result in the liability of a carrier overlapping that of an OTT, and which could have implications for recourse actions by a carrier against an OTT. It was suggested that the proposed study should take account of the information contained in the documentation prepared by UNIDROIT.

28. The Secretary of the Commission observed that, as a result of the discussions thus far, it had become apparent that, due to technological developments, functions were being performed in respect of goods in transport which had not been envisaged when rules governing various aspects of transport had evolved. As a result, such rules might in some instances become inappropriate. Moreover, inconsistencies could arise with respect to the application of existing international conventions dealing with transport. Therefore, the study requested of the secretariat would also address not only the implications with respect to the rules governing the operations of OTTs, but also the broader implications with respect to the existing rules governing international transport. The study would seek to ascertain whether the Commission, pursuant to its co-ordinating function in the field of international trade law, could make a contribution toward dealing with these broader implications. Such a project could be carried out by the Commission concurrently with the work on the liability of operators of transport terminals, and without affecting the scope or importance of this work. The Working Group agreed with the importance of such a project and agreed to recommend that the Commission should consider this matter.

B. Issuance of document

29. The Working Group considered whether the Uniform Rules should provide for a document to be issued by the OTT, whether such a document should be obligatory in all cases or only upon request of the

customer, and what should be the contents of such a document (issues 8 and 9, A/CN.9/WG.II/WP.52).

30. According to one view, a document should be required in all cases. In support of this view, it was suggested that a document was necessary in order to establish that the goods had been taken in charge by the OTT. In addition, it was suggested that a document was necessary in order to prove whether the goods were involved in international transport. Furthermore, if a document was required only upon the request of the customer, it would be difficult to prove whether such a request had been made. It was observed, however, that cases in which an OTT refused to issue a document when he had been requested to do so were not frequent. A suggestion was made that the OTT should be obligated in all cases to issue a simple receipt for the goods and that further information should be required in the document only upon the request of the customer.

31. The prevailing view was that the OTT should be obligated to issue a document only upon the request of the customer. In support of this approach, it was noted that there had been a trend toward discouraging the issuance of needless documentation covering goods involved in international transport. Moreover, such an approach was consistent with several international transport conventions which obligated the carrier to issue a transport document only upon the request of the shipper. It was observed that a document might not be needed by the customer in all cases. It was also observed that an OTT could issue a document upon his own initiative, without a request from his customer, if the OTT wished to protect his interests by establishing the date when he received the goods or the condition of the goods. Furthermore, it was pointed out that even without a document the customer could demand the release of the goods by the OTT in accordance with his contract with the OTT.

32. With respect to the contents of the document, one view suggested that the document should simply constitute a receipt for the goods, identifying the goods and showing when they were received by the OTT. In this regard, it was observed that a receipt of the OTT might be stamped upon a transport document covering the goods. The view was expressed that this should be regarded as the issuance of a document. Another view suggested that further information should be required, such as particulars concerning the condition and description of the goods, whether the OTT claimed rights of security in the goods, and if so, the charges in respect of which such rights were claimed and whether the document was negotiable. A further view suggested that if the document was issued by the OTT upon his own initiative it should be simply a receipt for the goods, but that the OTT should be obligated to provide further information if requested to do so by the customer.

33. A view was expressed that the Uniform Rules should provide for the issuance of a document by electronic or mechanical means. In this regard, a suggestion was made that the Uniform Rules should

adopt the approach contained in article 5 (2) of Montreal Protocol No. 4 to amend the Convention for the Unification of Certain Rules relating to International Carriage by Air signed at Warsaw on 12 October 1929 as amended by the Protocol done at the Hague on 28 September 1955. Under this approach, the OTT would be obligated to provide the customer with a receipt for the goods and allow him access to further information stored electronically. It was suggested that the Montreal Protocol served as the most advanced and acceptable model in this regard. According to another view, however, the provision of the Montreal Protocol might not serve as an appropriate model for Uniform Rules governing OTTs, since the purpose of the data envisaged in the Montreal Protocol was to provide a record of the carriage by air and since there was no need to provide for the OTT to issue a receipt which did not also contain all the other information stored electronically.

34. The Working Group considered the legal effect of a document to be issued by the OTT (issue 10, A/CN.9/WG.II/WP.52). According to one view, the legal effect should be governed by rules of national law other than the Uniform Rules. According to this view, a provision in the Uniform Rules as to the legal effect of a document could interfere with questions of proof, which were of domestic concern. The prevailing view, however, was that the document should constitute *prima facie* evidence of the taking of the goods in charge by the OTT as set forth in the document.

35. With respect to the question of whether the Uniform Rules should set forth a time-limit within which the OTT would be required to issue a document (issue 11, A/CN.9/WG.II/WP.52), one view was that the Uniform Rules should not specify a time-limit. In support of this view, it was suggested that, in accordance with the objective to simplify documentation, only a simple receipt should be issued for the goods; since such a receipt would normally be issued simultaneously with the taking over of the goods by the OTT, it was not necessary for the Uniform Rules to specify a time-limit. It was also suggested that the practice regarding the time when documents were to be issued varied with the type of operation concerned, and that it was not possible to establish a single time-limit. Moreover, it was suggested that the problem of a delay in issuing a document did not arise in practice.

36. Another view expressed support for specifying in the Uniform Rules the period of time within which a document must be issued. It was suggested that the absence of a time-limit would weaken an obligation of the OTT to issue a document. It was also suggested that the absence of a time-limit would make it difficult to apply sanctions for the untimely issuance of a document. According to one view, the Uniform Rules should contain a flexible formula for determining the period of time within which such a document must be issued (e.g. a reasonable time). According to another view, a short time-limit should be specified (e.g. 24 hours). A further view was expressed that no time-limit needed to be specified if a simple receipt was to be issued by the

OTT, but that a short time-limit should be specified for a document containing more particulars. It was suggested that, if a time-limit was to be provided, the Uniform Rules should specify when the period of time would begin to run.

37. The Working Group considered whether the Uniform Rules should contain sanctions for a failure by an OTT to issue a document as required (issue 12, A/CN.9/WG.II/WP.52). According to one view, sanctions were not needed, since the failure of an OTT to issue a document as required was not a problem in practice. It was in the interest of the OTT to issue such a document. It was also suggested that the question of sanctions should be resolved by rules of national law other than the Uniform Rules. However, considerable support was expressed for the view that if the OTT failed to issue a document as required, he should be presumed to have received the goods in good condition. It was suggested, however, that if the OTT had not received the goods and when there was no document issued, it was not reasonable to impose upon him the burden of proving that he did not receive the goods. It was pointed out that a failure to issue a document as required could make it difficult to identify the goods and, thus, could result in a delay in handing them over. In such a case, the sanction could be liability of the OTT for such delay.

38. The Working Group considered whether the Uniform Rules should provide for a negotiable document (issue 13, A/CN.9/WG.II/WP.52). According to the prevailing view, the Uniform Rules should not contain provisions concerning a negotiable document. In such a case, the parties could still agree that a negotiable document was to be issued if such a document was permitted under the rules of national law other than the Uniform Rules. In support of this view, it was suggested that the issuance of negotiable documents should not be encouraged by the Uniform Rules, in particular because of the problem of fraud connected with the use of such documents. In addition, there was no need for a negotiable document to be issued by the OTT, particularly if the goods were covered by a negotiable transport document. Moreover, problems could arise if two documents of title for the same goods were in existence at the same time. It was also pointed out that some legal systems prohibited the creation of a new negotiable document by agreement of the parties, and that a provision in the Uniform Rules concerning the issuance of a negotiable document could interfere with such a prohibition. However, it was noted that the Multimodal Convention foresaw in article 6 the issuance of a negotiable document for multimodal transport, while in article 13 it did not limit the issuance of other documents, negotiable or non-negotiable, for each of the various modes of transport or other services of which multimodal transport consisted.

39. Another view, however, favoured the inclusion of provisions in the Uniform Rules concerning the issuance of a negotiable document. Such a document could, for example, be useful in connection with storage of the goods for a length of time. In accordance with this

view, it was suggested that the Uniform Rules should provide for the issuance of a negotiable document if the parties so agreed and such a document was otherwise permitted under the law of the place where the operations of the OTT were performed. It was also suggested that, if the Uniform Rules provided for a negotiable document, they might also provide for other forms of transferrable documents in use in the place where the operations of the OTT were performed. Other views were expressed that, if a negotiable document were to be issued, it should be nominative and not made out to order or bearer.

40. An observation was made that, in connection with the document to be issued by the OTT, as well as in other contexts, the questions should be borne in mind as to what would constitute a writing (see, for example, article 1 (8) of the Hamburg Rules), and whether a requirement of a writing could be satisfied by new information storage and transmission techniques.

C. Standard of liability

41. The Working Group considered the standard of liability to which an OTT should be subject under the Uniform Rules (issue 15, A/CN.9/WG.II/WP.52). It was generally agreed that the liability régime governing OTTs should be aligned with the liability régimes under international transport conventions, in particular the Hamburg Rules and the Multimodal Convention, since an objective of the Uniform Rules was to fill the gaps in such transport liability régimes. Accordingly, it was generally agreed that the standard of liability governing OTTs should be the "presumed fault" standard as contained in those international transport conventions. It was noted that insurance considerations should be borne in mind when considering matters concerning the liability of OTTs. A view was expressed that further study of these considerations was required in respect of certain aspects of the proposed liability régime.

42. It was generally agreed that an OTT should be liable for the acts of his servants and agents. However, a view was expressed that an OTT should not be liable for acts of servants or agents outside their course of employment (e.g. theft by a servant not employed to look after the goods). According to another view, an OTT should be liable for such acts. It was observed, however, that this issue was treated in various ways by national law, and it was therefore preferable not to deal with it in the Uniform Rules.

43. The Working Group considered the question of whether liability for loss or damage attributable to the OTT and to another cause should be apportioned with respect to the OTT and the other cause. According to one view, the OTT should be jointly and severally liable with another person causing loss of or damage to the goods in order to protect the interests of the customer of the OTT. The prevailing view, however, was that the OTT should be liable in such cases only to the extent that the loss or damage was attributable to his fault or neglect, provided that he proved the amount of the loss

or damage not attributable thereto. In support of this view, it was suggested that the Uniform Rules should not purport to regulate the liability of persons who were not within the scope of the rules. It was, however, suggested that in this respect reference should be made not to the fault or neglect of the OTT, but only to a fact imputable to him by virtue of the rules governing his liability.

D. Liability for delay

44. The Working Group considered whether the Uniform Rules should deal with the liability of the OTT for delay in handing over the goods (issue 16, A/CN.9/WG.II/WP.52). According to one view, which received significant support, the Uniform Rules should provide for the liability of the OTT for such delay. In support of this view, it was suggested that delay by the OTT in handing over the goods was a problem which could occur in practice. A provision imposing liability for such delay was important for the protection of both consignees and shippers, as well as for carriers and forwarders who would be liable to their customers for delay which had been caused by OTTs and who would seek recourse against the OTTs for such delay. It was observed that without a provision imposing liability for delay, an OTT might be able to exclude such liability in his contract. In addition, a provision on liability for delay could also protect OTTs, in that their liability for delay could be limited by the Uniform Rules. If liability for delay were not included in the Uniform Rules, it would be governed by national law other than the Uniform Rules, which might expose the OTT to unlimited liability. Such liability could be extensive and could include, for example, liability for economic losses resulting from the delay. It was also suggested that international transport conventions imposed liability for delay, and that a provision on liability for delay in the Uniform Rules would contribute to filling the gaps in international transport liability régimes. Those favouring the inclusion of a provision on liability for delay considered that such a provision should in substance be similar to the comparable provisions in the Hamburg Rules and the Multimodal Convention.

45. According to another view, delay by the OTT was not a problem in practice, since the OTT who had the goods deposited with him had no reason to fail to hand over the goods on demand or at the specified time; the view was expressed that a provision on delay would meet with opposition by OTTs and would impair the acceptance of the Rules without being of any practical benefit. It was also suggested that it was difficult for OTTs to insure against liability for delay. A further view was expressed that delay might not present a significant problem in connection with safe-keeping operations, but might more frequently occur in connection with other types of operations.

46. It was agreed that an eventual draft of the Uniform Rules to be prepared for the Working Group should contain a provision dealing with delay by the OTT in handing over the goods, so that such a

provision could be reviewed by the Working Group when it considered the draft. In addition, references to delay should be included in other provisions as appropriate.

47. It was observed that article 6 (2) of the UNIDROIT preliminary draft Convention, which provided that the goods might be treated as lost if they were not handed over with 60 days following the request of the person entitled to take delivery of them, did not deal with the question of delay. It was generally agreed that it would be useful for the Uniform Rules to contain such a provision in addition to any provision on liability for delay.

E. Limit of liability

48. The Working Group considered whether the liability of the OTT for loss of or damage to the goods should be limited to a monetary amount and, if so, whether such a limit should be based upon an amount per kilogram, or some combination of an amount per kilogram and an amount per package (issues 17 and 18, A/CN.9/WG.II/WP.52). It was agreed that such liability should in any case be limited to an amount per kilogram. It was also agreed that it was premature to attempt to specify such an amount. A view was expressed that the limit of 2.75 units of account provided for in article 7 (1) of the UNIDROIT preliminary draft Convention was too low. It was observed that the limits of liability in some transport conventions were higher, and that too low a limit of liability in the Uniform Rules could prejudice recourse by a carrier against an OTT.

49. A view was expressed that the Uniform Rules should provide that the amount of the per-kilogram limit governing the liability of the OTT was to be the same as the amount of the limit contained in the international transport convention which governed the mode of transport to which the operations of the OTT were linked. According to another view, however, such an approach could be difficult to apply in cases where the OTT did not know which mode of transport was involved, in cases where more than one mode of transport was involved, and in cases, such as inland navigation, in which the liability of a carrier was not subject to a limit under an international convention.

50. According to one view, which received significant support, the liability of the OTT for loss of or damage to the goods should not be subject to a per-package limit. It was observed that it would not be appropriate for a single limit to apply to packages of differing sizes and containing goods of differing values. Moreover, courts had experienced difficulty in defining a "package". It was also suggested that problems could arise in respect of a per-package limit in the case of goods arriving in a terminal, for example in a container, which were damaged while still in the safe-keeping of the OTT after being repacked in smaller units.

51. The prevailing view, however, was that it was desirable for the Uniform Rules to contain a per-

package limit in addition to a per-kilogram limit. Such an approach would be consistent with the approach adopted in the Hamburg Rules and the Multimodal Convention, and would assist in recourse actions by carriers under those conventions. It was generally agreed that the Uniform Rules should contain the expedited revision procedure which was one of the provisions for revising limits of liability adopted by the Commission at its fifteenth session⁷ and recommended for use by the General Assembly.⁸

52. An observation was made that it was the practice in some areas for OTTs to limit their liability to an amount per cubic meter. Opinions were expressed that the Uniform Rules should not contain a total limit of liability for each event (issue 19, A/CN.9/WG.II/WP.52).

53. It was generally agreed that the Uniform Rules should enable the parties to agree to a higher limit of liability than the limit contained in the Rules (issue 21, A/CN.9/WG.II/WP.52). It was suggested that carriers should be able to negotiate with OTTs limits equal to those to which the carriers were subject, so as to enable them to recover fully in recourse actions against OTTs. It was also suggested that it was in the interest of both parties to be able to agree to higher limits when valuable goods were deposited with the OTT.

54. The Working Group considered whether the Uniform Rules should enable the limit of liability to be broken in certain circumstances (issue 22, A/CN.9/WG.II/WP.52). It was generally agreed that the limit of liability should be broken if the loss of or damage to the goods resulted from certain acts or omissions of the OTT itself, such as those acts or omissions referred to in article 9 (1) of the UNIDROIT preliminary draft Convention (e.g. acts or omissions of the OTT done with the intent to cause such loss or damage, or recklessly and with the knowledge that such loss or damage would probably result).

55. Differing views were expressed, however, as to whether the limit of liability should apply to the OTT if such acts or omissions were committed by his servants or agents. According to one view, the acts or omissions of the servants or agents of an OTT should not result in the breaking of the limit of liability applicable to the OTT. According to another view, the limit should be broken if such acts or omissions were committed by the servants or agents. A further view was expressed that the solution adopted in article 8 of the Hamburg Rules should be incorporated in the Uniform Rules. It was generally agreed that in view of the opinions expressed on this subject the eventual draft of the Uniform Rules should reflect the various points of view as alternatives.

56. It was generally agreed that in an action against a servant or agent of the OTT, the limit of liability should

⁷Report of the United Nations Commission on International Trade Law on the work of its fifteenth session, *Official Records of the General Assembly, Thirty-seventh Session, Supplement No. 17* (A/37/17), para. 63, annex III.

⁸General Assembly resolution 37/107 of 16 December 1982.

not apply to the servant or agent if such acts were committed by him under the same conditions under which, if an act were committed by the OTT he would not have been permitted to limit his liability.

F. Limitation or prescription period

57. The Working Group considered whether the Uniform Rules should establish a limitation period and, if so, how long the period should be and how it should be computed (issue 23, A/CN.9/WG.II/WP.52). It was agreed that a limitation period should be established with respect to actions against an OTT under the Uniform Rules, and that two years was an appropriate limitation period. It was observed that such a period would be consistent with the limitation periods established in other transport conventions. However, a view was expressed that in cases where the loss of or damage to the goods resulted from the wilful misconduct or acts or omissions of the OTT in bad faith, the limitation period of two years would not be appropriate and the establishment of a separate limitation period of a longer duration would be desirable.

58. A suggestion was made that the limitation period for actions against an OTT should commence on the day when the OTT handed over the goods. In the case of goods which were lost, it was suggested that the limitation period should commence at the time when the OTT informed his customer that the goods were lost, or when the goods could be treated as lost (see para. 47). A suggestion was made that, if the OTT was responsible for the goods during operations performed even after having handed them over (e.g. stowage), the limitation period in respect of damage caused by the OTT during such operations should commence at the time when such damage was caused.

59. The Working Group considered problems which could arise in connection with limitation periods applicable in recourse actions by or against an OTT. With respect to recourse actions against an OTT, it was observed that such a recourse action might be barred in cases, for example, where the OTT handed the goods over to the carrier, and the limitation period applicable in the recourse action against the OTT expired before the limitation period applicable in an action by a consignee against the carrier. There was large support for the view that the carrier's recourse action against the OTT should be preserved by providing in the Uniform Rules that such a recourse action could be brought even after the expiration of the limitation period. A suggestion was made that such a recourse action should be allowed to be brought within a specified period of time (e.g. 90 days) after the carrier had been held liable in the action against him. The view was expressed that the relevant time for the commencement of the specified period of time should be when the carrier had been held liable, rather than when he had been served with process or had settled the claim against him. Alternatively, the Uniform Rules should permit such a recourse action to be brought, notwithstanding the expiration of the limitation period provided

in the Rules, within the time allowed by the law other than the Uniform Rules in the State where the proceedings were instituted, which should be not less than a specified period of time (e.g. 90 days) from the time when the carrier had been held liable. It was, however, suggested that under such a provision the OTT would not have knowledge in advance of the time when recourse actions against him could be initiated. It was generally agreed that a recourse action by an OTT against another person whose liability was governed by the Uniform Rules should also be preserved by allowing such a recourse action to be brought even after the expiration of the limitation period applicable in actions against such persons.

60. The Working Group considered whether the Uniform Rules should contain a similar mechanism to preserve a recourse action by an OTT against a person whose liability was not governed by the Uniform Rules. The view was expressed that it would be beyond the scope of the Uniform Rules, which did not deal with the liability of such persons, to regulate the time when actions against such persons might be brought. Furthermore, when the liability of such persons was governed by international conventions, which established limitation periods for actions against such persons, the Uniform Rules should not interfere with such limitation periods. According to another view, however, the Uniform Rules should preserve a recourse action against a person whose liability was not governed by the Uniform Rules, if the limitation period applicable to actions against such persons was governed by national law and not by an international convention.

61. In view of the different possible approaches with respect to the issues referred to in paras. 57 to 60, it was agreed that the eventual draft of the Uniform Rules should contain alternative provisions reflecting the various possible approaches for further consideration by the Working Group.

62. The Working Group considered whether the Uniform Rules should contain provisions dealing with the interruption and suspension of the limitation period and other related issues (issue 24, A/CN.9/WG.II/WP.52). According to one view, the Uniform Rules should contain provisions regulating these issues in a uniform manner, since the treatment of such issues by national legal systems varied. According to another view, however, the Uniform Rules should contain no provisions at all on these issues, which would result in their being regulated by other rules of national law. It was observed, however, that the absence of provisions on these issues might be interpreted to exclude the possibility of interrupting or suspending the limitation period. The prevailing view was that these issues should be regulated by national law other than the Uniform Rules, and that the Uniform Rules should specify which national law would apply (e.g. the law of the forum).

G. Rights of security in goods

63. The Working Group considered whether the Uniform Rules should grant the OTT rights of security

in the goods for his costs and claims (issue 25, A/CN.9/WG.II/WP.52). It was generally agreed that the Uniform Rules should allow an OTT to retain the goods for his costs and claims arising from his operations with respect to the goods. It was also generally agreed that the parties should be able by agreement to grant to the OTT greater rights of security (e.g. by allowing the OTT to retain the goods to secure his costs and claims not only in respect of the same goods but also in respect of other goods which had been deposited with the OTT), if permitted by national law other than the Uniform Rules. A suggestion was made that the OTT should have such greater rights of security even without agreement if such greater rights were provided for in national law other than the Uniform Rules. According to another view, however, such an approach would be contrary to the objective of unification of law. A view was expressed that the OTT should have rights of security for costs and claims only in connection with safe-keeping.

64. It was generally agreed that the OTT should not be entitled to retain the goods if a sufficient guarantee for the sum claimed was provided or if an equivalent sum was deposited with a mutually accepted third party or with an official institution in the State where the operations of the OTT were performed.

65. With respect to the question whether the OTT should be able to sell the goods to satisfy his costs and claims, it was observed that some legal systems contained mandatory rules regulating such a sale; for example, in some legal systems the goods could be sold only under an order of a court. It was noted in this connection that article 5 of the UNIDROIT preliminary draft Convention came from the work of UNIDROIT in the field of the hotel-keeper's contract. It was therefore generally agreed that the Uniform Rules should enable the OTT to sell the goods only to the extent that national law other than the Uniform Rules allowed it and in accordance with the procedures and conditions contained in such national law. A view was expressed that the right of sale should be available only under the most extreme circumstances, and that such a restriction on the right of sale should be applicable whether the Rules took the form of a convention or of a model law. A suggestion was also made that rather than referring to "national law" in the contexts discussed in paras. 63 and 65, the Uniform Rules should specify the law of the place where the operations of the OTT were carried out as the applicable national law.

66. The Working Group considered whether the Uniform Rules should deal with the possible conflict of the exercise by the OTT of rights of security with the rights of a third person who was entitled to receive the goods (issue 26, A/CN.9/WG.II/WP.52). According to one view, the Uniform Rules should provide for such a conflict to be resolved by the national law, other than the Uniform Rules, of the place where the operations of the OTT were carried out. According to another view, such a conflict should be resolved by a provision in the Uniform Rules comparable to article 14 of the UNIDROIT preliminary draft Convention. A third

view was expressed that the Uniform Rules should not contain any provisions dealing with this issue. It was suggested that the parties would normally resolve these conflicts between themselves, and it was therefore preferable for the Uniform Rules to remain silent on the issue. It was also suggested that the question of the effects of the exercise by an OTT of his rights of security on the rights of third parties touched upon many aspects of commercial relations, and that the Uniform Rules should not attempt to deal with such matters.

67. A view was expressed that the Uniform Rules should oblige the OTT to notify all persons with an interest in the goods of the exercise by the OTT of his rights of security in the goods. It was observed that such a provision would enable such persons to take steps to protect their interests.

H. *Issues not dealt with in the preliminary draft Convention*

68. The Working Group considered whether the Uniform Rules should deal with the questions concerning the place where judicial or arbitral proceedings might be brought to resolve claims against OTTs (issue 27, A/CN.9/WG.II/WP.52). According to one view, the Uniform Rules should contain no provisions dealing with these questions. In support of this view it was suggested that no such provisions were needed because of the stationary nature of the operations performed by OTTs, and that the circumstances which made it desirable for such provisions to be included in certain international transport conventions (e.g. the Hamburg Rules) were not present with respect to the operations of OTTs. It was also suggested that, if the Uniform Rules contained provisions dealing with these issues, they would also have to contain provisions dealing with the recognition and enforcement of judicial and arbitral awards, which was beyond the scope of the Uniform Rules.

69. The prevailing view was that it was desirable for the Uniform Rules to contain some provisions concerning the place where judicial proceedings could be brought. In support of this view it was suggested that, if the Uniform Rules were silent as to this issue, the rules of national law would apply, which could result in a multiplicity of places where such proceedings could be brought, and possibly conflicts among places claiming jurisdiction. With respect to the contents of such provisions of the Uniform Rules, a view was expressed that, if the Rules were to deal with the issue of the place of jurisdiction over judicial proceedings, they should only permit the parties to agree as to where such proceedings could be brought and should not specify places where proceedings could be brought in the absence of such an agreement. The prevailing view, however, was that the Uniform Rules should permit the parties to agree upon the place where judicial proceedings could be brought and should further provide that in the absence of such an agreement the judicial proceedings could be brought in the place where the

operations of the OTT giving rise to the claim were performed or in the place where the OTT had his principal place of business. A suggestion was made that the Uniform Rules should also permit judicial proceedings to be brought in the place where the contract of the OTT was concluded. A view was expressed that the specification in the Uniform Rules of places having jurisdiction over judicial claims should not be exclusive.

70. A view was expressed that the Uniform Rules should also permit the parties to refer claims against an OTT to arbitration, which would be governed by the applicable law governing arbitral procedure.

71. The Working Group considered whether the Uniform Rules should deal with certain obligations of the customer towards the OTT (issue 29, A/CN.9/WG.II/WP.52). It was agreed that the Uniform Rules should not deal with the obligation of the customer to pay for the services of the OTT. In support of this approach, it was suggested that to deal with this issue would have consequences upon other rights and duties which could not be dealt with in the Uniform Rules. It was also observed that the obligation to pay for the services of the OTT would be referred to in other provisions of the Uniform Rules, and that this obligation would in any case be governed by the applicable law of contract.

72. It was also agreed that the Uniform Rules should not deal with an obligation of the customer to hold the OTT harmless from consequences of certain acts or omissions of the customer. In support of this approach, it was suggested that such matters could be dealt with in general conditions of contract or by national law other than the Uniform Rules.

73. It was, however, agreed that the Uniform Rules should deal with certain rights and obligations of the parties with respect to dangerous and perishable goods. A view was expressed that article 13 of the Hamburg Rules might be used as a general guide to approaches which might be adopted in respect of such issues. It was suggested that the Uniform Rules should obligate the customer to clearly mark and label dangerous goods, and to notify the OTT of the dangerous nature of such goods and of special handling needs or precautions to be taken with respect to them.

74. A view was expressed that the OTT should be entitled to reject dangerous or perishable goods tendered by his customer. According to another view, however, the OTT should not be entitled in all cases to reject such goods. A suggestion was made that this right should depend upon the practice with respect to the type of goods concerned. It was pointed out, however, that by virtue of rules to be established, there was no obligation to enter into a contract and therefore there would be no purpose in providing an exception to such an obligation.

75. Further views were expressed that the OTT should be able to deal with dangerous goods in an appropriate manner (e.g. by causing them to be removed or rendering them innocuous, if possible), and that the

obligation of the OTT to hand over the goods in the same condition in which he received them should not apply to dangerous or to perishable goods.

76. A view was expressed that the Uniform Rules should also deal with the liability of the customer to the OTT in respect of dangerous goods. A suggestion was made that the customer should be liable to the OTT for damage caused by dangerous goods if the customer had not notified the OTT of the dangerous character of the goods. According to another view, the Uniform Rules should not deal with this issue of liability. It was suggested that, if the liability issue was dealt with by the Uniform Rules, the Rules would also have to specify which types of goods were to be considered dangerous. According to another view, however, for the purposes of the Uniform Rules a definition of dangerous goods would not be required, particularly if the provision of the Rules was comparable to article 13 of the Hamburg Rules.

77. With regard to the liability of the parties to third parties for damage caused by dangerous goods, it was observed that such liability was the subject of other international conventions and of work in other organizations, and that it was beyond the scope of the Uniform Rules to deal with such liability.

78. A view was expressed that the Uniform Rules should provide that the OTT would not be liable to the customer for the deterioration of perishable goods if the customer did not inform him of the perishable nature of the goods.

III. Consideration of additional issues

A. *Non-contractual liability*

79. The Working Group considered whether the Uniform Rules should provide that the defences and limits of liability set forth therein should apply to an action under the Uniform Rules whether the action was founded in contract, tort or otherwise (additional issue 1, A/CN.9/WG.II/WP.53). It was agreed that the Uniform Rules should contain such a provision. A view was expressed in this connection that under article 1 (1) of the UNIDROIT preliminary draft Convention the application of the preliminary draft Convention was not limited to cases where an OTT received the goods under a contract. It was observed that a provision along the lines of article 8 (1) of the preliminary draft Convention (subject to some drafting changes) would prevent the claimant from avoiding the application of the defences and limits of liability contained in the Uniform Rules by bringing an action other than one based upon the contract with the OTT. It was also observed in this connection that it was possible in some legal systems for a claim to be brought by a person who was not in a contractual relationship with the OTT. It was agreed, however, that the Uniform Rules should not specify the categories of entities who were entitled to claim against the OTT (additional issue 2, A/CN.9/WG.II/WP.53).

B. Defences and limits of liability applicable to servant or agent of OTT

80. It was agreed that the Uniform Rules should entitle a servant or agent of the OTT acting within the scope of his employment to avail himself of the defences and limits of liability which the OTT was entitled to invoke under the Rules (additional issue 3, A/CN.9/WG.II/WP.53). A view was expressed that the Uniform Rules might also need to permit any other person of whose services the OTT made use to avail himself of such defences and limits of liability. On the other hand, it was agreed that the Uniform Rules should not deal with a situation in which an OTT acting as an agent of a carrier might be entitled, e.g. under an international transport convention, to invoke defences and limits of liability available to the carrier.

C. Notice of loss or damage

81. The Working Group considered whether the Uniform Rules should require notice of loss or damage to the goods to be given to the OTT and, if so, within what period of time such notice should be given and what should be the effect of a failure to give such notice (additional issue 4, A/CN.9/WG.II/WP.53). It was agreed that the Uniform Rules should require such notice to be given in writing to the OTT. It was observed that such a requirement would enable the OTT to preserve evidence relating to the notified loss or damage. A view was expressed that the loss required to be notified should be a partial loss or shortage of the goods, and that notice need not be required in the case of a total loss of the goods.

82. As to the period of time within which such notice should be given, it was agreed that apparent and non-apparent loss or damage should be treated differently. With respect to apparent loss or damage, it was agreed that the period of time should be very short (e.g. not later than the working day after the day when the goods were handed over).

83. Various views were expressed with respect to the period of time which should be required for giving notice of non-apparent loss or damage. It was agreed that in general the period of time should be longer than the notice period for apparent loss or damage. According to one view, notice for non-apparent loss or damage should be required to be given within a certain number of days (e.g. 15) after the goods had been handed over by the OTT. An observation was made, however, that such an approach might create problems with regard to containerized goods which were lost or suffered damage while in the custody of an OTT at the beginning of transport, such loss or damage not being discovered until the container was opened and the goods were examined at the end of the transport and after the notice period had expired. A question was raised as to whether this problem was of practical importance. It was suggested that such a situation could occur, for example, when the container was detained during customs formalities.

84. As one approach for dealing with a problem such as that referred to in the previous paragraph, it was suggested that if the notice period was to commence at the time when the goods were handed over by the OTT it should be long enough to enable notice to be given by the recipient of the goods (e.g. 30 to 60 days). Another suggested approach was for the notice period to commence at the time when the goods reached their final destination. A view was expressed, however, that under such an approach the position of the OTT could be insecure, particularly if several weeks elapsed before the goods reached their final destination. It was suggested that this insecurity could render the Uniform Rules unattractive to OTTs and could create problems for the eventual acceptance of the Rules. A third suggested approach was to provide that, if under certain specified circumstances the claimant could prove that it was not possible for the loss or damage to be discovered within the notice period commencing when the goods were handed over by the OTT, the notice could be given when it became possible for the loss or damage to be discovered. It was considered that notice should be required to be given in any case within an overall period of time (e.g. 60 days) from the time when the goods were handed over by the OTT.

85. A view was expressed that it was not possible to accommodate completely the interests of both the claimant and the OTT. The degree of balance between these interests would to some extent depend upon the legal consequences of a failure to give notice to the OTT as required (e.g. whether a failure to give notice would extinguish a claim for loss or damage or would merely shift the burden of proof of the condition of the goods handed over). In this connection, the view was expressed that the decision on the approaches to be adopted with respect to length of the notice period and the time when it should commence to run should be taken bearing in mind the consequences which a failure to give notice would have.

86. It was generally agreed that with respect to both apparent and non-apparent loss or damage, if notice of such loss or damage was not given as required by the Uniform Rules, the handing over of the goods by the OTT should be *prima facie* evidence of their having been handed over as described in the document issued by the OTT or, if no such document had been issued, in good condition. However, one view was that this consequence should apply only in the event of a failure to give notice of apparent loss or damage, and that the Uniform Rules should not expressly provide for the consequences of a failure to give notice of non-apparent loss or damage.

87. With regard to notice relating to delay, it was noted that in accordance with the previous discussion by the Working Group on the subject of liability for delay, the eventual draft of the Uniform Rules would contain a provision dealing with this subject, and reference to delay would be included in other provisions of the Rules as appropriate (see para. 46). With respect to the question of whether the Uniform Rules should require notice to be given to the OTT of delay in the

handing over of the goods, a view was expressed that it was not necessary to require such notice since the delay would be known to him even without notice. According to another view, however, the Uniform Rules should require notice of loss resulting from delay to be given to the OTT since such notice could assist the OTT in protecting his interests in connection with a claim for such loss. With respect to the contents of such a provision, a view was expressed that article 19 (5) of the Hamburg Rules should be used as a model, and that a claim for such loss should be extinguished if notice was not given within 60 days after the handing over of the goods.

88. In connection with its discussion of the issue of notice in general, the Working Group also referred to the question of whether a carrier should be obligated to give notice to an OTT, and whether an OTT should be obligated to give such notice as may be required to be given to a carrier under applicable legal rules, in order to protect the right of the consignee to recover for loss of or damage to the goods (issue 28, A/CN.9/WG.II/WP.52). It was generally agreed that it was not necessary to deal with these questions at this stage.

89. It was agreed that the Uniform Rules should not deal with the question of to whom notice should be given (additional issue 5, A/CN.9/WG.II/WP.53). It was suggested that this issue gave rise to a number of related issues which the Uniform Rules should not attempt to resolve.

D. Contractual stipulations

90. The Working Group considered whether the Uniform Rules should permit an OTT by agreement to derogate from the provisions of the Rules, or to increase his responsibilities and obligations under the Rules (additional issue 6, A/CN.9/WG.II/WP.53). A view was expressed that this issue was somewhat related to the question of the extent to which the Uniform Rules should be mandatorily applicable to all OTTs in States adopting the Rules or whether the Rules should permit States to apply the Rules only to OTTs agreeing to be bound by them. In connection with this view, it was suggested that, although that question had not yet been considered by the Working Group, the eventual draft of the Uniform Rules should contain in square brackets a provision dealing with the question in order to assist the Working Group in considering the relationship of the question with the issue of whether an OTT should be permitted by agreement to derogate from the Rules. The prevailing view, however, was that the question related to the form of the Uniform Rules, consideration of which had been deferred until after work on the substantive issues had been completed, when it would be known how such issues were to be treated (see para. 13). It was generally agreed that the eventual draft of the Uniform Rules to be prepared for consideration by the Working Group should only contain provisions on substantive issues and that they should not contain final provisions, including a clause dealing with the mandatory applicability of the Uniform

Rules, which would not by that stage have been discussed by the Working Group.

91. It was agreed that the OTT should be able by agreement to increase his responsibilities and obligations under the Uniform Rules. With respect to the question of whether the Uniform Rules should permit the OTT to reduce his responsibilities and obligations, a view was expressed that the parties should have freedom of contract, unless a contrary need was demonstrated. The prevailing view, however, was that the OTT should not be able to reduce his responsibilities and obligations under the Uniform Rules. It was suggested that to permit the OTT to do so would be inconsistent with the uniform liability régime sought to be established by the Uniform Rules. Therefore, article 12 of the UNIDROIT preliminary draft Convention was considered to be a broadly acceptable formulation of a provision dealing with this issue. A further view was expressed that, while it was acceptable to prohibit the OTT from reducing his responsibilities and obligations relating to safe-keeping, a different approach might be desirable with respect to responsibilities and obligations relating to other operations, if the Uniform Rules were to cover such other operations.

92. A view was expressed that the Uniform Rules should require the document to be issued by the OTT to contain a statement that the operations of the OTT were subject to the Uniform Rules; article 23 (3) of the Hamburg Rules would serve as a model for such a provision. According to another view, whether such a provision was desirable depended upon the nature of the document which the Rules would require.

E. International transport conventions

93. The Working Group considered whether the Uniform Rules should provide that they did not modify rights or duties which might arise under an international convention relating to the international carriage of goods (issue 7, A/CN.9/WG.II/WP.53). It was agreed that the Uniform Rules should contain such a provision, but that it should refer only to international transport conventions which were binding on the State where the OTT was located. In particular, if, under the applicable law, provisions of the Uniform Rules as well as those of an international transport convention applied to a given situation, nothing in the Rules should modify rights and duties arising under the convention. A suggestion was made that consideration might also be given to the question of whether the Uniform Rules should provide that they were not to modify rights and duties arising under national legal rules relating to transport.

F. Interpretation of the Uniform Rules

94. The Working Group considered whether the Uniform Rules should contain a provision dealing with the interpretation of the Rules, such as article 15 of the UNIDROIT preliminary draft Convention (additional issue 8, A/CN.9/WG.II/WP.53). It was agreed that a

provision dealing with the interpretation of the Uniform Rules was desirable, but that the formulation contained in article 3 of the Hamburg Rules and article 7 of the Convention on the Limitation Period in the International Sale of Goods (New York, 1974)⁹ should be followed. In support of this approach, the view was expressed that in Uniform Rules such as those under consideration the reference to "general principles" in article 15 (2) of the preliminary draft Convention was not appropriate. An observation was also made that article 15 of the preliminary draft Convention separated the interpretation of the Uniform Rules from the application of the Rules, which was not desirable.

IV. Other business and future work

95. The Working Group requested that the secretariat, taking into account the discussion at the present session, should prepare for the next session draft provisions of Uniform Rules for operators of transport terminals, accompanied by a study referred to in para. 27.

96. A statement was made by the observer from the United Nations Conference on Trade and Development (UNCTAD) that in response to resolution 144 (VI) adopted by the UNCTAD Conference at its sixth session in Belgrade in June, 1983, the UNCTAD secretariat would prepare a study on the rights and duties of container terminal operators and users. The study would be submitted to the twelfth session of the UNCTAD Committee on Shipping scheduled for 1986. The observer noted that the mandate of UNCTAD was narrower than that of UNCITRAL in its scope of

application, since the mandate of UNCTAD was limited to studies on rights and duties of container terminal operators and users. He stated that UNCTAD would contribute to the work of the Commission so that all possible duplication of work would be avoided. The observer stated that the UNCTAD study would also take into account the discussions of the Working Group, as well as the preparatory work undertaken by UNIDROIT with regard to the liability of OTTs. However, he expressed the wish that UNCTAD be given an opportunity to comment upon the outcome of the work of the Working Group before finalization by the Commission.

97. The Working Group welcomed the co-operation offered by UNCTAD as another indication of the increasing co-ordination developing between UNCTAD and UNCITRAL. In view of the expected rapid progress of this project within the Working Group, the Secretary of the Commission also welcomed the agreement of the UNCTAD secretariat to provide the UNCITRAL secretariat with the results of its study as it progressed. He referred to the customary practice of the Commission to seek the comments of Governments and interested international organizations before a legal text was adopted by the Commission, and stated that, accordingly, the Commission would welcome the views of UNCTAD as an influential and important body in the field of shipping, in particular in the field of international multimodal transport.

98. The Working Group, taking into account circumstances relating to the availability of conference services, as well as already scheduled meetings of other organs dealing with topics in the field of international transport which would be attended by some representatives of member States and observers of the Working Group, decided to recommend to the Commission that the next session of the Working Group be held in New York in January 1986.

⁹A/CONE.63/15. See *Official Records of the United Nations Conference on Prescription (Limitation) in the International Sale of Goods* (United Nations publication, Sales No. E.74.V.8).

B. Working papers submitted to the Working Group

1. Liability of operators of transport terminals: issues for discussion by the Working Group: note by the secretariat (A/CN.9/WG.II/WP.52)

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I. Mandate of the Working Group

1. The Commission, at its seventeenth session, had before it a report of the Secretary-General titled "Liability of operators of transport terminals" (A/CN.9/252). The report discussed some of the major issues which arose from the preliminary draft Convention on the Liability of Operators of Transport Terminals prepared by the International Institute for the Unification of Private Law (UNIDROIT) and which might merit consideration in the formulation by the Commission of Uniform Rules on this topic. The text of the preliminary draft Convention was annexed to the report.

2. After considering the report and the preliminary draft Convention, the Commission decided to assign to its Working Group on International Contract Practices the task of formulating Uniform Legal Rules on the liability of operators of transport terminals (hereinafter referred to as OTTs). It further decided that the mandate of the Working Group should be to base its work on document A/CN.9/252 and on the UNIDROIT preliminary draft Convention and the Explanatory Report thereon¹ prepared by UNIDROIT, and that the Working Group should also consider issues not dealt with in the UNIDROIT preliminary draft Convention, as well as any other issues which it considered to be relevant.² The text of the Explanatory Report is being issued as an addendum to this note.

II. Method of work

3. The Working Group may wish to consider its method of work for carrying out the task assigned to it by the Commission. During deliberations at the seventeenth session of the Commission, a suggestion was made that the Working Group should begin its work by considering approaches to be adopted with respect to issues arising in connection with the liability of OTTs and then proceed to the drafting of the Uniform Rules. The Commission was generally agreed that the method of work of the Working Group should be determined by the Working Group itself.³

4. The Working Group might find it advantageous first to engage in a comprehensive consideration of all of the issues arising in connection with the liability of operators of transport terminals, based on document A/CN.9/252 and the UNIDROIT preliminary draft Convention and Explanatory Report, prior to proceeding with drafting the Uniform Rules. Such an approach could enable the Working Group to adopt a common basis as regards the principles, policies and directions upon which the Uniform Rules are to be based. Moreover, where issues are connected with each other, in that the solution of one issue will influence the position taken with regard to another issue, a comprehensive consideration of all issues prior to drafting should help in drafting the provisions of the Uniform Rules to which such issues are relevant since the views regarding such issues will have been ascertained at least on a tentative basis. As suggested in document A/CN.9/252 (para. 47), the Working Group may wish to defer its decision on the ultimate form the Uniform Rules should take until after it has drafted a text of the Uniform Rules.

5. The present note provides a list of issues which might serve as a basis for the deliberations of the Working Group. These issues have been derived from document A/CN.9/252 and from the UNIDROIT preliminary draft Convention and Explanatory Report, as well as from views which were expressed at the seventeenth session of the Commission.⁴ The list of issues dealt with in this note need not, of course, be considered as exhaustive. To assist the Working Group, the present note also contains annotations to the portions of document A/CN.9/252, the preliminary draft Convention and the Explanatory Report relevant to each issue.

III. Issues possibly to be addressed by Uniform Rules

A. Scope of application of Uniform Rules

1. Relationship of Uniform Rules to international transport

Issue 1

Should the application of the Uniform Rules be limited so as to apply only to operations of OTTs in respect of goods in international transport?

¹UNIDROIT document, Study XLIV—Doc. 24.

²Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17 (A/39/17)*, para. 113.

³*Ibid.*, para. 108.

⁴*Ibid.*, paras. 109 and 110.

Annotation

A/CN.9/252, paras. 5-8.

Preliminary draft Convention, articles 1 (1) and 2 (b).

Explanatory Report: paras. 9-11, 15, 23-26, 32 and 33.

Remarks

At the sixteenth session of the Commission, a suggestion was made that the application of the Uniform Rules should not be limited to operations of OTTs in respect of goods in international transport, but that the Rules should also apply to operations in respect of goods not involved in transport.⁵ The Commission requested the secretariat to consider this issue in the study which was to be submitted to the seventeenth session;⁶ the issue is therefore discussed in document A/CN.9/252, as indicated in the above annotation.

Issue 2

If the application of the Uniform Rules is to be limited to operations of OTTs in respect of goods in international transport, should the application of the Rules depend upon the existence in fact of a link with international transport (hereinafter referred to as the "objective approach") or upon the actual or constructive knowledge of the OTT of the existence of such a link (hereinafter referred to as the "subjective approach")?

Annotation

A/CN.9/252, paras. 6, 7, 9 and 10.

Preliminary draft Convention, articles 1 (1) and 2 (b).

Explanatory Report, para. 33.

Remarks

If the Uniform Rules are to apply merely if there exists in fact a link with international transport, the OTT may face certain difficulties as discussed in paras. 6 and 7 of document A/CN.9/252 and para. 33 of the Explanatory Report.

Issue 3

If the Uniform Rules are to apply merely due to the existence in fact of a link with international transport (i.e. the objective approach), should the nature of this link be defined, and if so, how?

Annotation

A/CN.9/252: paras. 9 and 10.

Preliminary draft Convention and Explanatory Report, as noted under issue 2, above.

⁵Report of the United Nations Commission on International Trade Law on the work of its sixteenth session, *Official Records of the General Assembly, Thirty-eighth Session, Supplement No. 17 (A/38/17)*, para. 113.

⁶*Ibid.*, para. 115.

Remarks

The following are possible formulations of such a link:

(a) The Uniform Rules are to apply to operations of an OTT which are related to carriage in which the place of departure and the place of destination are situated in two different States.

(b) The Uniform Rules are to apply to operations of an OTT in respect of goods carried in international transport, which are performed between the time when the goods are taken over from the shipper by a carrier, a multimodal transport operator or a freight forwarder in one State and the time when the goods are delivered to a consignee in another State.

(c) The Uniform Rules are to apply to operations of an OTT in respect of goods carried in international transport which are performed during a period of time beginning when a carrier, a multimodal transport operator or a freight forwarder first becomes liable for the goods under an international transport document or under legal rules applicable to international transport. The period of time ends upon the occurrence of either of the following events, whichever is later: (1) the goods are made available to the consignee or (2) the liability of the carrier, multimodal transport operator or freight forwarder for the goods ceases to be governed by an international transport document or by legal rules applicable to international transport.

Formulation (a), above, is the formulation adopted in the preliminary draft Convention (article 2 (b)). As noted in document A/CN.9/252 (para. 10), such a formulation could give rise to questions in particular cases as to whether the Rules are applicable.

It may be noted that under formulation (b), above, the Uniform Rules would apply in a case, for example, where goods which are ultimately to be transported internationally are picked up from the shipper and deposited with an OTT in the same State by a carrier who is not acting under a contract for international carriage. If it were determined that the Uniform Rules should not apply to the operation of the OTT in that and similar cases, the application of the Rules might be made to commence at the time indicated in formulation (c), above. Under formulation (c), the operations of the OTT in the foregoing example would be governed by the Uniform Rules if the OTT were acting for a carrier who became liable for the goods under an international transport document or an international transport convention when the goods were delivered to the OTT. Moreover, it may be noted that under formulation (b), above, in a case where at the end of international transport a carrier delivers the goods to an OTT acting for the carrier, the Uniform Rules might govern the operations of the OTT even after the goods are made available to the consignee and the consignee fails to collect them. To exclude such a case from the application of the Uniform Rules, the period of application of the Uniform Rules might be made to terminate as indicated in formulation (c), above (see A/CN.9/252, footnotes 11 and 12).

Issue 4

If the application of the Uniform Rules is to depend upon the actual or constructive knowledge of the OTT of a link with international transport (i.e. the subjective approach), how should such an approach be formulated?

Annotation

A/CN.9/252, para. 7.

Preliminary draft Convention and Explanatory Report, as noted under issue 2, above.

Remarks

A possible formulation of the subjective approach may be that the Uniform Rules are to apply if the OTT knew or ought to have known that the goods were to be, were being or had been transported internationally. The OTT could acquire such knowledge if, for example, the customer were to give notice to that effect to the OTT. It may be desirable to join this formulation with formulation (b) or (c) of the objective approach, discussed under issue 3, above. This would ensure that the Uniform Rules would not apply to operations of an OTT which were too remote in time to the international transport.

2. *Types of operators and operations to be governed by Uniform Rules*

Issue 5

Should the Uniform Rules apply only when the safe-keeping of the goods is performed as a primary operation, or should they also apply when (a) the safe-keeping of the goods is performed not as a primary operation but only ancillary to handling operations, and (b) when only handling operations are performed?

Issue 6

If the Uniform Rules are to apply to handling operations, to which handling operations should they apply?

Annotation

A/CN.9/252, paras. 11 to 16.

Preliminary draft Convention, articles 1 (1) and 3.

Explanatory Report, paras. 12, 14, 16, 21-23, 27, 34-39.

Issue 7

If the Uniform Rules are to cover handling operations, should the OTT be liable for loss of or damage to the goods which arises as a result of such handling operations but which does not occur until after the goods have been handed over?

Annotation

Preliminary draft Convention, article 3.

Explanatory Report, para. 39.

*B. Issuance of document**Issue 8*

Should the Uniform Rules provide for a document to be issued by the OTT in respect of goods taken in charge by him? If so, should such a document be obligatory in all cases, or only upon the request of the customer?

Annotation

A/CN.9/252, paras. 17-19.

Preliminary draft Convention, article 4.

Explanatory Report, paras. 17, 40-43.

Remarks

If this issue is to be governed by conditions of contract or by national legal rules other than the Uniform Rules, it may be preferable for the Uniform Rules expressly so to state, rather than to remain silent as to the issue. Otherwise, the Uniform Rules might be erroneously interpreted in such a way as to exclude the right or obligation not dealt with, rather than to have it governed by conditions of contract or other rules of national law. These remarks apply equally to some other issues identified in this note which the Working Group might decide would be preferable to be dealt with by conditions of contract or other rules of national law rather than by the Uniform Rules.

Issue 9

If the Uniform Rules provide for the issuance of a document by the OTT, what should be the required contents of such a document?

Annotation

A/CN.9/252, para. 26.

Preliminary draft Convention, article 4 (1) and (2).

Explanatory Report, paras. 41-44.

Remarks

The Working Group may wish to consider whether some of the following types of information should be required to be provided in the document: location of the transport terminal; date of issuance of the document; date of taking in charge of the goods; whether the document is negotiable (see issue 13, below); the nature of the goods; the quantity and condition of the goods, in so far as they can be reasonably ascertained; a statement of the fees or expenses in respect of which the OTT claims rights of security in the goods (see issues 25 and 26, below). The Working Group may also wish to consider whether an authorized signature on behalf of the OTT should be required.

Issue 10

If the Uniform Rules provide for the issuance of a document by the OTT, should they also provide for the legal effect of such a document, and, if so, what should be the legal effect? (See also issue 14, below.)

Annotation

A/CN.9/252, para. 26.

Preliminary draft Convention, article 4 (3).

Explanatory Report, para. 45.

Issue 11

Should the Uniform Rules specify a time-limit within which the OTT would be required to issue such a document? If so, what time-limit should be specified?

Annotation

A/CN.9/252, para. 24.

Issue 12

Should the Uniform Rules provide sanctions for a failure by the OTT to issue a document which he is obligated to issue? If so, what should be the sanctions?

Annotation

A/CN.9/252, para. 25.

Explanatory Report, para. 43.

Issue 13

Should the Uniform Rules provide for a negotiable document? If so, should an OTT be obligated to issue a document in negotiable form in all cases or only upon the request of the customer, or should such a document be issued only if both parties agree?

Annotation

A/CN.9/252, paras. 20-22.

Preliminary draft Convention, article 4 (4).

Explanatory Report, para. 46.

Issue 14

If the Uniform Rules provide for a negotiable document, should they also regulate the position and rights of transferees of such a document, and if so, how?

Annotation

A/CN.9/252, para. 23.

Preliminary draft Convention, article 14.

Remarks

A possible approach to the position of a good-faith transferee of the document who relies on an inaccurate description of the goods in the document might be the approach adopted in the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg) (hereinafter referred to as the Hamburg Rules), article 16 (3), which provides that proof that the goods are not as described in a bill of lading is not admissible if the bill has been transferred to a third party who in good faith has acted in reliance on the description of the goods.

With respect to a conflict between the rights of a person entitled to the goods under a transport document and the rights of a holder of a negotiable document issued by an OTT covering the same goods, the Working Group may wish to consider whether the likelihood of such a conflict arising in practice is sufficient to justify dealing with it in the Uniform Rules. It may also wish to consider whether a solution which subordinates the rights of the holder of the document issued by the OTT to those of a person entitled to the goods under a transport document (see, e.g. preliminary draft Convention, article 14) would impair the value of a negotiable document issued by the OTT.

*C. Standard of liability**Issue 15*

Should the Uniform Rules establish a single standard of liability to apply to all operations of OTTs governed by the rules? If so, what should the standard be?

Annotation

A/CN.9/252, paras. 27-29.

Preliminary draft Convention, article 6 (1).

Explanatory Report, paras. 13, 53, 54, 56 and 57.

*D. Liability for delay**Issue 16*

Should the Uniform Rules deal with the liability of the OTT for delay in handing over the goods?

Annotation

A/CN.9/252, paras. 30-32.

Preliminary draft Convention, article 6 (2).

Explanatory Report, para. 55.

*E. Limit of liability**Issue 17*

Should the Uniform Rules provide a per-package limit of liability as an alternative to a per-kilogram limit?

Annotation

A/CN.9/252, para. 39.

Explanatory Report, para. 58.

Remarks

The Hamburg Rules (article 6 (1)) and the United Nations Convention on International Multimodal Transport of Goods (article 18 (1)) provide that the higher of the per-package or the per-kilogram amount shall constitute the limit of liability. See, however, para. 39 of document A/CN.9/252.

Issue 18

Should the liability of an OTT for loss of or damage to the goods be limited to a certain amount, and if so, to what amount?

Annotation

A/CN.9/252, paras. 33 and 34.

Preliminary draft Convention, article 7 (1) and (2).

Explanatory Report, paras. 58 and 59.

Remarks

Under the preliminary draft Convention, the liability of the OTT is limited to 2.75 units of account per kilogram (article 7 (1)).

Issue 19

Should the Uniform Rules provide, in addition to a per-kilogram or per-package limit of liability, a total limit of liability for each event?

Annotation

A/CN.9/252, para. 38.

Explanatory Report, para. 59.

Issue 20

If the Uniform Rules provide a total limit of liability for each event, should they also provide a means of apportioning the available recovery among various claimants in the event the total amount of damages exceeds the limit?

Annotation

A/CN.9/252, para. 38.

Issue 21

Should the Uniform Rules enable the parties to agree to a higher limit of liability than the limit contained in the Rules?

Annotation

A/CN.9/252, para. 35.

Preliminary draft Convention, article 7 (3).

Explanatory Report, para. 60.

Issue 22

Should the Uniform Rules enable the limit of liability to be broken in certain circumstances, and if so, in which circumstances?

Annotation

A/CN.9/252, paras. 36 and 37.

Preliminary draft Convention, article 9.

Explanatory Report, paras. 13, 62 to 65.

*F. Limitation or prescription period**Issue 23*

Should the Uniform Rules establish a limitation or prescription period for bringing an action against an OTT under the Rules? If so, how long should the period be and how should it be computed?

Annotation

A/CN.9/252, para. 40.

Preliminary draft Convention, article 11.

Explanatory Report, paras. 13 and 70.

Remarks

The Working Group may wish to take note of the problem discussed in para. 40 of A/CN.9/252, i.e. that a two-year period applicable to an action against an OTT, computed from the time when the goods are handed over or may be treated as lost (as in the preliminary draft Convention, article 11 (1) and (2)) could in some cases bar a recourse action by a carrier or a multimodal transport operator. This problem might be dealt with by providing that a recourse action against an OTT by an entity which has received the goods from the OTT and against which a claim has been made for loss of or damage to the goods may be instituted even after the expiration of the limitation period ordinarily applicable to the OTT if it is instituted within a specified period of time after the entity has received notice of the claim against him, after he has settled such a claim, or after he has been held liable for such loss or damage. If the Working Group adopts this approach in principle, it may wish to consider upon which of the three events just noted the specified period of time should begin to run (compare preliminary draft Convention, article 11 (5); Convention on the Limitation Period in the International Sale of Goods (New York, 1974) (hereinafter referred to as the Prescription Convention), article 18 (3)).

Issue 24

Should the Uniform Rules contain detailed provisions relating to the interruption, suspension, extension or cessation of the limitation period?

Annotation

A/CN.9/252, para. 41.

Explanatory Report, paras. 71 and 72.

Remarks

The Working Group may wish to consider whether the Uniform Rules should contain detailed provisions dealing with when judicial or arbitral proceedings for claims and counterclaims which cause the limitation period to cease to run are deemed to have been commenced, the effect on the running of the limitation period of an ending of such proceedings without a binding decision on the merits, the circumstances under which a new limitation period is to commence, and the extension of the limitation period in cases in which

proceedings cannot be brought for reasons beyond the control of the claimant (see Prescription Convention, articles 13 through 21).

G. *Rights of security in goods*

Issue 25

Should the Uniform Rules grant the OTT rights of security in the goods for his costs and claims relating to the goods? If so, what should be the nature of such rights?

Annotation

A/CN.9/252, paras. 42-44.

Preliminary draft Convention, article 5.

Explanatory Report, paragraphs 13, 48-52.

Remarks

To secure sums due to the OTT in respect of the goods, the Uniform Rules might grant to the OTT the right to retain the goods until such sums are paid. They might also grant him the right to sell the goods in order to satisfy the debt. (See preliminary draft Convention, article 5.)

The working group may wish to note that such rights could impede the flow of goods, and it may wish to consider additional approaches to minimize this effect. Under one such approach, the OTT could be given the right to retain and sell goods for the purpose of securing not only sums due to the OTT in respect of the same goods, but also other sums due to the OTT (e.g. in respect of goods previously deposited with the OTT). This would enable the OTT to release to a regular customer goods in respect of which sums are owed to the OTT, since such sums could be secured by goods deposited later with the OTT. Under a second approach, the party entitled to receive the goods could be enabled to procure their release by obtaining a guarantee or by depositing with a third party a sum sufficient to secure the sum claimed by the OTT (see preliminary draft Convention, article 5 (2)). Under a third approach, the OTT could be given a non-possessory right of security in the goods to which the goods would remain subject, even if possession of the goods were transferred, until the debt secured by the right of security was discharged. However, non-possessory rights of security are not recognized in all legal systems; moreover, they would require a legal framework regulating their existence and operation (e.g. rules regulating the rights of transferees of the goods, rules establishing priorities among various claimants in respect of the goods, and rules concerning public notice). Therefore, it might be desirable to accord to the OTT a non-possessory right of security only if such a right is otherwise recognized by the law in the State where the operations of the OTT are carried out (see preliminary draft Convention, article 5 (1)).

Even if the Uniform Rules were to grant to the OTT a right of retention or sale of goods, whether to secure

sums due to the OTT in respect of such goods or to secure other sums due, it might be useful to provide that questions relating to such rights not dealt with in the Uniform Rules are to be governed by national legal rules other than the Uniform Rules.

Issue 26

If the Uniform Rules grant the OTT rights of security in the goods, should they also deal with the effects of such rights on rights of a person who is entitled to the goods but who is not the customer of the OTT? If so, how should this issue be treated?

Annotation

A/CN.9/252, paras. 43 and 44.

H. *Issues not dealt with in preliminary draft Convention*

Issue 27

Should the Uniform Rules deal with the questions of jurisdiction over judicial claims and the place of arbitration of claims against OTTs?

Annotation

Explanatory Report, para. 69.

Remarks

If the Working Group decides that the Uniform Rules should contain rules regarding jurisdiction over judicial claims and the place of arbitration of claims against an OTT, the Rules might specify one or more of the following places as places in which such judicial or arbitral claims may be brought: the principal place of business of the OTT; the place where the contract with the OTT was made, if the OTT has a place of business there; the place where the operations of the OTT were carried out; or any other place set forth in the contract with the OTT. The Working Group might also wish to consider including a provision comparable to articles 21 (5) and 22 (6) of the Hamburg Rules, whereby after a claim under a contract for carriage by sea has arisen, the parties may by agreement designate the place where the claimant may institute judicial or arbitral proceedings.

Issue 28

Should the Uniform Rules obligate a carrier to notify an OTT of the loss of goods which were to be handed over to the carrier for subsequent transport and delivery to the consignee, or to notify an OTT of damage to goods handed over to the carrier for subsequent transport and delivery to the consignee, in order to protect the right of the consignee to recover for such loss or damage?

Remarks

An obligation of the carrier to protect the consignee by giving such notice to the OTT might be aimed at situations where, for example, the OTT hands over goods

to the carrier and the consignee later alleges that he did not receive the correct quantity of goods or that goods which he received were damaged, and the loss or damage might have been sustained while the goods were in the custody of the OTT. It may be noted, however, that under the preliminary draft Convention (article 10 (1)) the right of the consignee to recover for loss of or damage to the goods might not be defeated by a failure of the carrier to give such notice. In such a case, the handing over of goods to the carrier would be *prima facie* evidence of delivery of the goods as described in the document issued by the OTT or in good condition. If the OTT was acting for the carrier, the consignee could still claim against the carrier for the loss or damage. Even if the OTT was not acting for the carrier, the consignee could claim against the carrier, and this claim would be aided by the *prima facie* evidentiary effect of the handing over of the goods by the OTT that the goods were delivered as described in the document issued by the OTT or in good condition, plus the evidentiary effect of any bill of lading or other transport document issued by the carrier showing that the goods were received by him in the correct quantity or in good condition. Issuance by the carrier of a transport document showing that he received goods from the OTT in an insufficient quantity or in a damaged condition, or proof by the carrier in the claim against him that he

received the goods from the OTT in an insufficient quantity or in a damaged condition, could be used to overcome the *prima facie* evidentiary effect of the handing over of the goods by the OTT in a claim by the consignee against the OTT. Moreover, the Working Group may wish to consider whether the Uniform Rules are the proper place for imposing on the carrier an obligation to protect the right of the consignee to claim for loss of or damage to the goods.

Issue 29

Should the Uniform Rules deal with obligations of the customer towards the OTT, such as (a) an obligation to pay for the services performed by the OTT; (b) an obligation to inform the OTT as to any dangerous character of the goods and a corresponding right of the OTT not to accept the goods, or to deal with them in a way appropriate to their character; (c) an obligation to hold the OTT harmless from any consequences caused other than by dangerous goods, such as a liability to authorities for deficiencies in documentation?

Annotation

A/CN.9/252, para. 45.

Explanatory Report, para. 20.

2. Explanatory report to the preliminary draft Convention on the Liability of Operators of Transport Terminals, prepared by the secretariat of UNIDROIT: note by the secretariat (A/CN.9/WG.II/WP.52/Add.1)

(For reference only)

[The Explanatory report is reproduced in Yearbook XV, 1984, part two, IV, C, in connection with the text of the preliminary draft Convention, since it was made available in the form of a UNIDROIT document at the seventeenth session of the Commission (New York, 25 June-10 July 1984). The report is noted here for

reference since it was reproduced during the period covered by this Yearbook as UNCITRAL document A/CN.9/WG.II/WP.52/Add.1 for the eighth session of the Working Group on International Contract Practices (3-14 December 1984).]

3. Liability of operators of transport terminals: additional issues for discussion by the Working Group: note by the secretariat (A/CN.9/WG.II/WP.53)

Additional issue 1

Should the Uniform Rules provide that the defences and limits of liability provided for therein apply whether the action is founded in contract, tort or otherwise?

Additional issue 2

Should the Uniform Rules specify those categories of entities who are entitled to claim against the OTT?

Hamburg Rules, article 7 (1).

Multimodal Convention, article 20 (1).

Remarks

A provision such as that contained in article 8 (1) of the preliminary draft Convention, whereby the Rules would apply to actions founded in tort or otherwise, would hold open the possibility of actions being brought against the OTT by persons other than those in a contractual relationship with the OTT. However, the issue of who may claim against the OTT is not directly addressed by the preliminary draft Convention. In some legal systems, a claim against an OTT performing services in connection with maritime transport may be

Annotation

Preliminary draft Convention, article 8 (1).

Explanatory Report, para. 61.

brought only by an entity in a contractual relationship with the OTT. In other legal systems, a claim may be brought by persons who are not in such a relationship with the OTT but who have an interest in the goods. The Working Group may wish to consider whether it would be preferable to specify categories of entities who may bring claims against the OTT or to leave this issue to be settled by rules of national law other than the Uniform Rules.

Additional issue 3

Should the Uniform Rules entitle a servant or agent of the OTT acting within the scope of his employment to avail himself of the defences and limits of liability which the OTT is entitled to invoke under the Rules?

Annotation

Preliminary draft Convention, article 8 (2).

Explanatory Report, para. 61.

Hamburg Rules, article 7 (2).

Multimodal Convention, article 20 (2).

Remarks

An OTT acting as an agent of a carrier may be able to benefit from defences and limits of liability which are applicable to the carrier under the relevant transport convention, if the transport convention contains a provision similar to article 7 (2) of the Hamburg Rules, or if the transport document issued by the carrier contains a "Himalaya clause". Those defences and limits of liability may be more favourable to the OTT than the ones provided for in the Uniform Rules. Such a situation may present no difficulty in the context of a recourse action by the carrier against the OTT, since the defences and limits of liability which the OTT would be entitled to invoke in the recourse action would be the same as those which the carrier could invoke in the action against him. On the other hand, in an action by a cargo interest directly against the OTT, such a situation might entitle the OTT to invoke more favourable defences and limits of liability than would otherwise be available to him under the Uniform Rules. The Working Group may wish to consider whether it is desirable or possible to permit an OTT acting as an agent for a carrier to invoke the defences and limits of liability available to the carrier only in recourse actions by the carrier against the OTT.

It may be noted that under article 8 (2) of the preliminary draft Convention, a servant or agent of the OTT would be able to invoke only the defences and limits of liability available to the OTT under the Convention, and not those which may be available to the OTT as described in the preceding paragraph.

Additional issue 5

Should the Uniform Rules require notice of loss of or damage to the goods to be given to the OTT? If so, within what period of time should such notice be given, and what should be the effect of a failure to give such notice?

Annotation

Preliminary draft Convention, article 10.

Explanatory Report, paras. 66-68.

Hamburg Rules, article 19.

Multimodal Convention, article 24.

Remarks

The discussion in the remarks to issue 28 in document A/CN.9/WG.II/WP.52 may be relevant in this regard.

The Working Group may wish to consider whether the 15 days notice period for non-apparent damage is sufficient. A situation could occur, for example, in which containerized goods suffer damage while in the custody of an OTT immediately prior to carriage by sea, but the damage is not discovered until the container is opened after the end of the voyage, which could be longer than 15 days after the OTT hands the container over to the carrier.

It may be noted that some general conditions provide for a longer period of notice (e.g. 60 days) than the periods specified in the preliminary draft Convention, but also provide that a claim for loss or damage against the OTT would be barred if notice were not given as required.

Additional issue 6

Should the Uniform Rules provide to whom notice may be given?

Remarks

The preliminary draft Convention does not deal with this question. One approach might be to leave the issue to be resolved by rules of national law other than the Uniform Rules.

The Working Group may wish to consider whether it would be desirable for the Uniform Rules to provide that notice given to a carrier on behalf of whom the OTT was acting also constitutes notice to the OTT. Such a provision might be appropriate in order to deal with the situation in which the goods were deposited by a carrier with an OTT acting as his agent and were handed over by the OTT to the consignee, who discovered that they were damaged. One possibility may be to provide that notice to the carrier also constitutes notice to the OTT. In this connection, it may also be desirable for the Uniform Rules to specify against whom the *prima facie* effect of a failure to give notice operates (e.g. only against the person who received the goods).

Additional issue 7

Should the Uniform Rules provide that an OTT may not by agreement derogate from the provisions of the Rules? Should the Uniform Rules enable the OTT to increase his responsibilities and obligations under the Rules?

Annotation

Preliminary draft Convention, article 12.
Explanatory Report, paras. 73 and 74.
Hamburg Rules, article 23.
Multimodal Convention, article 28.

Remarks

A provision such as article 12 (2) of the preliminary draft Convention could help to protect a carrier's right of recourse against an OTT, if the carrier's responsibilities and obligation toward the cargo interest were higher than those of the OTT toward the carrier.

Additional issue 8

Should the Uniform Rules provide that they are subordinate to rights and duties arising under an international convention relating to the international carriage of goods?

Annotation

Preliminary draft Convention, article 14.
Explanatory Report, para. 76.

Remarks

A provision such as article 14 of the preliminary draft Convention could have various consequences, including the following:

(a) It could exclude a carrier from the coverage of the Rules while he is subject to an international transport convention.

(b) It could hold rights under a transport document paramount to rights under a document issued by an OTT.

(c) It could hold the rights of a person entitled to receive the goods under a transport document paramount to rights of security of the OTT in the goods.

The Working Group may wish to consider whether the Uniform Rules should be subordinate to rights and obligation arising even under an international transport convention to which the State where the OTT performs his operations is not a party.

Additional issue 8

Should the Uniform Rules contain a provision comparable to article 15 of the preliminary draft convention?

V. AUTOMATIC DATA-PROCESSING

Legal value of computer records: report of the Secretary-General (A/CN.9/265)^a

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^aFor consideration by the Commission, see *Report*, chapter VI, B (part one, A, above).

Introduction

1. The Commission at its fifteenth session in 1982 considered a report of the Secretary-General containing a discussion of certain legal problems arising in electronic funds transfers.¹ In respect of the question of the legal value of computer records, the report concluded: "The problem, while of particular importance to international electronic funds transfers, is one of general concern for all aspects of international trade. Generalized solutions would, therefore, be desirable."² On the basis of this report, the Commission requested the secretariat to submit to some future session a report on the legal value of computer records in general.³

2. Subsequent to the fifteenth session of the Commission, the Working Party on the Facilitation of International Trade Procedures, a body jointly sponsored by the Economic Commission for Europe and the United Nations Conference on Trade and Development, considered a report on the legal aspects of automatic trade data interchange, which concluded, *inter alia*, "that there is an urgent need for international action to establish rules regarding legal acceptance of trade data transmitted by telecommunications. Since this is essentially a problem of international trade law, the United Nations Commission on International Trade Law (UNCITRAL) would appear to be the central forum."⁴ At the request of the Working Party, the report was forwarded by the Executive Secretary of the Economic Commission for Europe to several international organizations for their consideration and was submitted to the Commission at its sixteenth session as an annex to document A/CN.9/238.

3. As part of the preparation for the current report, the secretariat prepared a questionnaire on the use of computer-readable data as evidence in court proceedings. The purpose of the questionnaire was to collect information on the evidential value of records stored or transmitted in computer-readable form. At the same time and in co-operation with the secretariat of the Commission, the Customs Co-operation Council prepared a questionnaire on the acceptability to customs authorities of a goods declaration in computer-readable form and subsequent use of such a declaration in court proceedings. The questionnaire prepared by the secretariat of the Commission was sent to Governments and was included for information with the questionnaire sent by the Customs Co-operation Council. The questionnaire prepared by the Customs Co-operation Council was sent to its member States and was included for information with the questionnaire sent by the secretariat of the Commission. The two questionnaires were sent concurrently to ensure co-ordination between ministries in preparation of the replies. The information

contained in the replies has been used in the preparation of this report.⁵

I. Business records

A. Types of business records

4. Transaction-oriented business records, which are the subject-matter of this report, are those which record the activities of an enterprise. Whether created or stored on paper or in a computer, they can be classified as either (1) originals or copies of transaction documents, (2) chronological records of transactions or (3) summary records of those transactions. Although the different characteristics of these types of records pose somewhat different problems in regard to their legal value when they are maintained in computer-readable form rather than in paper-based form, they share the characteristic of recording actual events.

5. The legal value of business records of an enterprise which do not reflect transactions, such as an analysis of its activities and its planning operations for the future, is determined by criteria different from those used for transaction-oriented records and is not considered in this report.

6. *Transaction documents* include such inter-enterprise documents as contracts, purchase orders, confirmations, shipping documents and payment instructions. They include such intra-enterprise documents as memoranda, time records, leave slips and inventory requisitions. They also include documents submitted to the State for such purposes as customs clearance or exchange control.

7. The records of an enterprise can be expected to contain the originals of the transaction documents which have been received from outside the enterprise and copies of the transaction documents which have been sent outside the enterprise. The original is often authenticated by signature or its equivalent, but copies retained by the sender usually do not show the authentication. Both the originals and copies can be expected to show one or more dates, which may be significant depending on the manner shown. The documents may show a sequence number indicating the order in which they were used, sent or received by the enterprise. Transaction documents are the basic documents on which all other records of an enterprise are based and their authenticity as to source, date and content is fundamental in case of later inquiry or dispute. Since the long-term storage of paper-based transaction documents is expensive, many documents are reproduced or recorded by microfilming or on computer and the originals are destroyed either immediately or after a restricted period of time.

⁵An analytical summary of the replies received by the secretariat is contained in the annex to this document. It may be useful to read the annex before reading the text of the main report. A summary of the replies received by the Customs Co-operation Council is contained in its document no. 31.678, and those replies are reflected in this report to the extent relevant.

¹A/CN.9/221 (and Corr. 1, French only).

²*Ibid.*, para. 81.

³Report of the United Nations Commission on International Trade Law on the work of its fifteenth session, *Official Records of the General Assembly, Thirty-seventh Session, Supplement No. 17* (A/37/17), para. 73.

⁴TRADE/WP.4/R.185/Rev.1, para. 4 of the foreword.

8. Administrative documents prepared by enterprises must conform to the requirements specified by the administration for the documents in question. In many cases the document is in the nature of a printed form to be filled out by the enterprise. Some documents required in international trade must conform to a format prescribed in an international convention. The records of the enterprise would contain only a copy of the document as it was submitted to the administration.

9. *Chronological records*, such as the accounting journal of an enterprise or a log of incoming or outgoing communications, set forth in chronological order the sending or receipt of transaction documents. Some chronological records contain the content of the events represented by the transaction documents. A chronological record may also consist of a file of transaction documents kept in chronological order.

10. A chronological record may be authenticated, but often is not. A chronological record which is dated and sequential establishes a strong presumption that it reflects the activities of the type in question for that period of time. The strength of the presumption depends on such factors as the extent to which transaction documents are required for all relevant transactions, the extent to which they are required to carry sequence numbers and the rigour with which they are entered into the chronological record.

11. *Summary records*, such as an accounting ledger, record transactions relevant to a particular account or activity. They allow for the current status of that account or activity to be easily assessed. Although entries to summary records may be authenticated, they often are not.

12. In most cases the records of an enterprise which are of ultimate legal significance are the transaction documents. Chronological and summary records are often of legal significance only as a means of easily determining what events have occurred and as an index to the transaction documents which serve as the evidence of those events. However, in some cases the chronological or summary documents are of legal significance in their own right. Dividends may be payable only to those persons shown to be stockholders on the stockholder ledger of the enterprise. Posting of the debits and credits to the customer account in a bank may constitute honour of a cheque or payment order.

B. *Physical nature of business records*

1. *Paper-based documents and records*

13. Paper can be used for any type of transaction document or for any type of business record. Since paper is durable, paper-based documents and records can be expected to remain in existence for a longer period of time than is usually economically or legally necessary. Alteration of the document or other record can normally be detected. As methods of altering paper-based documents and records have improved, the

techniques for making paper which readily shows alterations have also improved. The document or record can be authenticated by signature or other means. Paper-based documents are portable. They can be sent by messenger or mailed to distant places, thereby permitting the transmission of the data, the instructions or the legal rights symbolized by the document. These are the characteristics of paper which have made it desirable as a medium on which documents or records are kept.

2. *Electronic documents and records*

(a) *Telegraph and telex*

14. Intra- and inter-enterprise transaction documents have been sent by telecommunications in the form of telegraph and telex for over a century. From the viewpoint both of business use and of legal consideration, telegraph, telex and allied technologies have generally been considered to have many of the characteristics of paper-based documents. Since both the sender and the receiver of the message retain a paper copy, legal requirements that a contract or other document must be in writing have been generally considered to be fulfilled by the exchange of telegrams and telex.⁶

15. Telegraph, telex and allied technologies have, however, had several technical limitations which have affected their usefulness and have created certain legal difficulties. Since the technology has been limited to the sending of messages in linear form, the use of telegraph and telex has been limited to those messages which could by their nature be transmitted in that form. Therefore, although they have been widely used to transmit such transaction documents as purchase orders, acknowledgments, confirmations, and payment instructions, they could not be used to send messages which had to be received in a particular format, such as chronological or summary records or transaction documents of the nature of bills of lading or most administrative documents. However, if the enterprise had personnel or agents at the place a transaction document was needed, its data content could often be transmitted to that place for entry on the appropriate forms.

16. Telegraph and telex permit limited possibilities for authentication. By their very nature they cannot be signed. This normally does not interfere with their use in business or with their use as evidence in case of later dispute, since the context of the message and standard call-back procedures give adequate assurance of their source. Where assurance of the source is particularly important to the parties and may be of later importance in case of dispute, test keys and related procedures can be used. Nevertheless, and in spite of the widespread use of telex for commercial purposes, adequate authen-

⁶See, for example, United Nations Convention on Contracts for the International Sale of Goods (United Nations publication, Sales No. E.81.IV.3) (A/CONF.97/18), annex I, art. 13. "For the purposes of this Convention 'writing' includes telegram and telex".

tication of telex messages remains a serious problem where possibilities of fraud are significant.

17. Because the transmission charges for telegraph and telex have been relatively expensive, contract offers, acceptances and other documents have often been sent in summary form and the full text sent in a later mailed confirmation. This has raised problems where the confirmation differed in some material respect from the telecommunicated message. A similar problem is raised when the text of a telegram or telex is altered in a material respect during transmission. However, legal rules have been developed to resolve these conflicts without casting doubt on the legal value of the telecommunication itself.⁷

(b) *Paper-based documents prepared on computer*

18. Paper-based documents are often prepared on computers, including word-processors. In its reply to the Customs Co-operation Council, the United States reported that a 1982 survey showed that 60 per cent of the goods declarations submitted to the customs authorities in that country were prepared on computers.⁸ These documents would seem to have the same physical and legal characteristics as similar documents prepared on a typewriter.⁹ In any case, it may currently be impossible to tell whether a particular paper-based document was prepared on a typewriter or on a computer.

(c) *Documents transmitted computer-to-computer*

19. Computer-to-computer telecommunications can be used to create paper-based documents at a distant location. One advantage of this technology over earlier telecommunications technology is that the document can be transmitted in the format required for paper-based documents of the type in question. This has been discussed as one means to ensure that bills of lading are available at the port of destination before the goods arrive. However, if the paper-based document must be authenticated by signature or other means which requires action on the document, the sender of the document would continue to need an authorized representative at the destination.

20. It has often been noted that one party may prepare transaction documents on a computer, print out the documents in an acceptable format and transmit them to the recipient, who may promptly re-enter the data into his own computer. The re-entry of the data is done at considerable expense and at the risk of error. Both the expense and the error rate are reduced if the re-entry of the data from the paper-based

document can be accomplished automatically by machine reading. It can be reduced even more if the document can be transmitted directly between the two computers without the necessity of transmitting paper-based documents.

21. Computer-to-computer transmission of transaction documents is usually done in a format suitable for further computer processing. The transaction between the parties may call for a print-out at either end, but the technology does not require one since the transaction document can be read, stored and processed in computer-readable form. Transaction documents can be transmitted individually by telecommunications or in batch-mode by exchange of computer memory devices or by telecommunications.

22. Authentication of documents transmitted in batch-mode by exchange of computer memory devices is often done by signature on an accompanying paper which identifies the batch. Authentication can also be accomplished by electronic techniques as it can for documents sent by telecommunications.

(d) *Storage of data in computer-readable form*

23. One of the primary characteristics of computers has been the ease with which records could be corrected and brought up to date. This is a great advantage for the preparation of all documents and records and for maintenance of current summary records, such as a ledger account for accounts receivable. It is a serious disadvantage for the permanent storage of all types of business records considered in this report. Transaction documents sent or received should be stored in an unalterable form. It should be possible to add new items to the end of a chronological record, but not to alter an item once it is recorded. Summary records showing the status of an account or of an activity as of fixed dates, e.g. status at the end of the year, should be stored in an unalterable form.

24. Alterations to data could occur either inadvertently as a result of technical factors or human errors or deliberately. Particular concern has been expressed over the possibility that records may be deliberately altered. Unauthorized alterations of records, which are facilitated by remote access to the computers storing the records, are of serious concern to the enterprises whose records have been altered and raise many legal questions in regard to civil and criminal liability for those acts and for their consequences. More serious problems for the legal acceptability of computer records are raised by the possibility that the enterprise itself might deliberately alter its records, since this possibility casts doubt on the credibility as evidence of all computer-stored records.

25. The protection of the records of an enterprise from unauthorized alteration has been raised to a high art, and the procedures and technology available continue to improve. If the recommended procedures are rigorously followed, unauthorized penetration of the computer system is unlikely. Many of these same procedures are also useful against deliberate alteration by the enterprise itself. However, relevant legal rules

⁷*Ibid.*, art. 27, which provides that "... if any ... communication is given ... 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".

⁸Customs Co-operation Council document no. 31.678, cited in footnote 5, above.

⁹The reply given by several States to question 8 of the UNCITRAL questionnaire that a print-out would not satisfy the requirement of written form seems in large measure to be directed at specific types of records and would not preclude every form of record from being prepared on a computer.

must take into consideration the possibility that the technical means of protecting the data from alteration may not have been used or may have failed.

26. In order to store computer records in a form which could not be altered, some enterprises have stored authenticated and dated hard copies of all significant records. Recent technological developments using optical disks seem to permit the storage of data in an unalterable form. The generalized use of such storage media for transaction documents and for the permanent storage of chronological and summary records as of fixed dates would reduce the concerns as to whether the record may have been altered. However, further technological developments may discover means to alter the content of optical disks as well.

II. Evidential value of computer records

A. Legal rules on reception of evidence

27. There are three major variations on the general law of evidence which affect the evidential value of computer records.¹⁰ The variations are based on different legal traditions and practices in the fact-finding process in civil and commercial disputes.

1. Free introduction of all relevant evidence

28. In many legal systems, the litigants are in principle allowed to submit to the tribunal all information which is relevant to the dispute. If there is a question as to the accuracy of the information, the tribunal must weigh the extent to which it can be relied upon. In these legal systems, there is in principle no obstacle to the introduction of computer records as evidence in judicial or arbitral proceedings.

2. Exhaustive list of admissible evidence

29. Some States establish an exhaustive list of acceptable evidence, which always includes written documents as one of the acceptable forms of evidence. The States falling into this group which replied to the questionnaire had not amended the list to include computer records, although several indicated that a reform of the law was contemplated or in various stages of implementation. As a result, in a few of those States computer records were not admissible as evidence in any court. In other States replying to the questionnaire, a computer record might be relied upon to furnish to the court a presumption as to the facts in the case.

30. Moreover, in some of these States the restriction on the use of non-written evidence is found in the civil law governing non-commercial matters. In commercial matters, as well as in criminal trials, non-written evidence may be freely accepted. In those States, a computer record may, therefore, be generally acceptable as evidence in all matters of commercial dispute.

3. Common law hearsay evidence limitation

31. In principle, common law countries employ an oral and adversarial procedure in litigation. As part of that dual tradition, a witness can testify only to what he knows personally so as to allow the opponent an opportunity to verify the statements by cross-examination. What he knows through a secondary source, e.g. another person, a book or a record of an event, is denominated "hearsay evidence", and, in principle, the tribunal cannot receive it as evidence.

32. Because of the difficulties which the hearsay evidence rule has caused, there are many exceptions to it. One of those exceptions is that a business record created in the ordinary course of commercial activity may be received as evidence even though there may be no individual who can testify from personal knowledge and memory as to the particular record in question. In some common law countries, a proper foundation must be laid for the introduction of the record by oral testimony that the record is of a normal nature. In others, the record is automatically accepted subject to challenge, in which case the party relying upon the record must show that it is of the proper kind.

33. Some common law countries have accepted computer print-outs as falling within the business records exception to the hearsay-evidence rule. Many common law countries have adopted special laws providing that computer records may be admitted as evidence if certain conditions are fulfilled.¹¹ The conditions for admission of computer records may be different in criminal trials from the conditions for admission in civil cases,¹² but there would normally be no distinction regarding the admission of the computer records of an enterprise between litigation against another commercial enterprise and litigation against a consumer.

34. As a result of these developments, there are no remaining theoretical or philosophical objections to the use of computer records as evidence in common law jurisdictions. Objections to the admission of particular computer records, however, are based on a claim that the record in question had not been shown to meet the statutory or court-enunciated criteria for admission.

B. Trustworthiness of computer records in individual cases

35. The trustworthiness of computer records has been evaluated at three levels. At the most general level, those legal systems which do not allow the free introduction of all relevant evidence have had to decide whether computer records in general were sufficiently trustworthy to be admissible as evidence before a court.

¹⁰Several of the common law respondents included copies of the relevant legislation.

¹²The differences between the rules for admission in civil cases and in criminal proceedings were pointed out in the reply of the United Kingdom. The law in respect of computer-readable output as evidence was the subject of legislation before Parliament at the time of the reply in the summer of 1984.

¹⁰Annex, question 1.

As noted above, with some exceptions among countries with an exhaustive list of admissible evidence, a decision in favour of admissibility has generally been made. At a second level, the common law legal systems have had to provide criteria for the courts to determine in individual cases whether the data stored in a particular computer or computer system is sufficiently trustworthy to be admitted as evidence in regard to specific matters in a particular litigation. The other legal systems do not face this problem. At a third level, courts in all legal systems must evaluate in individual cases the credibility of the computer record before them.

1. *Criteria for admissibility in common law courts*

36. Although the specific criteria for the admissibility of computer records differ in the various common law countries, they fall into three categories. Firstly, the proponent of the record is required to show that the computing equipment used was such that it may be expected to have functioned properly. It may be necessary to show that the equipment was designed to perform the tasks it was asked to undertake, that the various elements of hardware were compatible and that the software was appropriate. Secondly, it must be shown that in entering information into the computer appropriate procedures were followed to ensure the accuracy of the record, e.g. that the entries were made in the regular course of business at or reasonably near the time of occurrence of the event recorded. Thirdly, it must be shown that the method of storing and processing information and preparing the print-out, i.e. the programming, operation and control of the computer, was such as to assure the trustworthiness of the record.¹³

37. Some common law statutes have been drafted in the context of off-line batch-processing, where the closed nature of the system has permitted the party relying on the evidence to describe the system to the tribunal in relative detail. In newer systems, however, the computer itself may make decisions as to how the data will be processed depending upon intermediate results. It may not be possible to describe the process followed in regard to a particular record in these systems. Similar difficulties are faced in describing to a tribunal for its evaluation a distributed processing system, especially if any portion of the processing is done by outside value-added facilities, or in describing the relationship between the system at one enterprise at which a computer record was created and the system at a second enterprise to which the record was transmitted by physical exchange of computer memory device or by

telecommunications. As a result of these technological developments, some common law statutes may not provide an adequate legal basis for the courts to admit computer records from the more complex systems.¹⁴ However, these same developments have led the courts to accept more general statements from the proponent of the computer record tending to establish that the computer system has been working properly.

38. Although the normal rules governing the use of hearsay evidence would require a person who is familiar with the computer system to present in oral testimony before the court the information necessary for admitting the computer-stored data as evidence, most of the laws specifying the procedure to be used for the admission of computer records permit the submission of an affidavit by that person, eliminating the need for oral testimony unless there is a dispute as to the accuracy of the data. In the case of enterprises which maintain computer systems with a high degree of professional care and which keep detailed records of every aspect of the system and its operations, it may be sufficient for the affidavit to be quite simple.¹⁵

39. At the present time, even if there is a challenge to the accuracy of the data, it would be rare for a court in most common law countries to refuse to admit computer-stored data into evidence for evaluation as to its credibility by the jury or by the court in its role as the finder of fact unless the terms of the statute had not been drafted in the light of current technology,¹⁶ the computer system was managed in an unprofessional manner, or the data to be presented were the result of sophisticated analysis by the computer and the assumptions underlying the analysis and the procedures by which the analysis had been made were not clearly documented and acceptable. This latter problem, however, is seldom posed in respect of the recording and data-processing of documents and other records of an enterprise.

2. *Evaluation by court of credibility of computer-stored data*

40. Computer-stored data may be inaccurate even if the proponent has shown the system to be sufficiently well-managed for the data to be admitted as evidence in a common law court. There is an even greater possibility that inaccurate data will be placed before the court in other legal systems which have no procedure for refusing admittance of untrustworthy data from an

¹³The "seven statements" to be made to a common law court to support the admissibility of computer-stored data as suggested in A. Kelman and R. Sizer, *The Computer in Court* (Aldershot, Gower, 1982), p. 71, may be compared with the requirements for computer-stored data which are to be used as evidence in the largely civil law courts of the member States of the Council of Europe, as those requirements are reflected in Council of Europe recommendation No. R (81) 20, appendix, arts. 3 and 5, 11 December 1981, reproduced in the report of the Secretary-General on electronic funds transfer (A/CN.9/221).

¹⁴According to the reply from one common law country, a computer record received from a computer of another firm would probably not be admissible (see annex, question 6). This would seem to raise doubts as to the legal security of all inter-bank electronic funds transfers in that country.

¹⁵See the pro-forma certificate drafted in the United Kingdom for use under the Civil Evidence Act 1968, in *The British Computer Society, Computer Generated Output as Admissible Evidence in Civil and Criminal Cases*, T. R. H. Sizer and A. Kelman, ed. (Heyden, 1982), figure 2.

¹⁶The reply from the United Kingdom noted that "the Acts in question were passed in 1968 and 1972 and the definition of computer is 'any device for storing and processing information', which appears to mean hardware but not software".

individual computer system. In either case, when the accuracy of the data is challenged, the court must evaluate it for its credibility.

41. The weight to be given to computer-stored data may be established by legal rule. Council of Europe Recommendation No. R (81) 20 provides that a computer recording of the books, documents and data designated by law as being among those which can be kept on computer and made in conformity with the procedures set out in articles 3 and 5 of the appendix "shall be presumed to be a correct and accurate reproduction of the original document or recording of the information it relates to, unless the contrary is proven".¹⁷ This presumption of accuracy would be in conformity with the presumption of accuracy given to written documents and records of an enterprise in some countries. However, it appears that in most countries the court would be free to evaluate the credibility of computer-stored data on the basis of the evidence before it.¹⁸

42. It is not known whether any legal system has given the courts guidance as to the factors which they should take into consideration in evaluating the credibility of the computer record. However, it would seem that the factors to be considered by a common law court in deciding whether to admit computer-stored data in evidence, which are similar to the factors set forth by the Council of Europe in the appendix to its Recommendation, would be the primary factors to be considered in favour of the accuracy of the data. In addition, a number of replies to the questionnaire indicated that where data have been transmitted from one computer system to another, the evidential weight of the data stored in the computer of the second firm would also depend on the measures taken to prevent risk of alteration of data during transmission.¹⁹ Since a common law court would already have considered the same factors and found the computer system sufficiently trustworthy to admit the data as evidence, a strong presumption that the data are accurate may in fact be established in the mind of the court, with the result that the party contesting the accuracy of the data may carry a burden of proof not established by legal rule. While the technical problem is somewhat different, the party contesting the accuracy of a computer record in other legal systems may face the same difficulty once the proponent of the record has established that the computer system was well managed. The party attacking the accuracy of a computer record must have means of determining whether the computer system may have defects in design or maintenance which could lead to inaccuracies in result. In the common law countries, this would normally occur by means of "discovery".²⁰

In the civil law countries, the evaluation may often be carried out by an expert appointed by the court.

C. Best evidence—original or copy?

1. Recording in computer from original paper document

43. It has been a general rule of evidence that documents and other records had to be presented to a court in their original form so as to assure that the data presented to the court were the same as the original data. However, in recent years the large savings which can be realized by storing microfilms or computer recordings of original paper documents and destroying the originals has led many States to permit their use as evidence in place of the original.²¹

44. The data from an original paper document may be transferred to a computer in several ways. An image of the document can be stored in digital form and later reproduced in visual form when needed. It is, however, less expensive to record only the essential data on the document. In this latter case, the visual form of the document when reproduced would not be the same as the original. Therefore, in some cases an image of particularly important segments of the document, such as the signature, may also be recorded. At present, data capture by automatic means from a paper document is largely limited to data printed in type-faces designed for automatic reading. Other data which are handwritten or which are printed or typed in other type-faces may need to be entered into the computer by re-keying. New equipment is in development which promises to increase substantially the amount of data on paper documents which could be captured automatically and accurately.

45. Although the technology of transforming a paper document to a computer record is different from that used in microfilming the records for storage, the legal problems are similar. Firstly, data capture does not allow for testing whether the paper document had been altered as to content or authentication prior to its transformation into the new form for storage. Secondly, the content of the original paper record may not have been accurately captured and transformed into a computer record. This is a rare problem where the data were captured automatically from a paper record which was printed or typed in a type-face designed for automatic capture. It is a more likely event if the data were entered into the computer by re-keying. Thirdly, the computer record is subject to subsequent deliberate or inadvertent alteration. This, however, is a problem common to all computer records.

46. As a result of these concerns, some States require enterprises which have reproduced paper-based documents on microfilm or recorded them on computer to keep the original documents for varying periods of time

¹⁷Council of Europe recommendation No. R (81) 20, appendix, art. 2, 11 December 1981.

¹⁸Annex, question 4.

¹⁹Annex, question 6.

²⁰The rules of discovery are themselves complex and may not be sufficient to allow for adequate testing of a computer system. For a brief description of the law in Australia and proposal for reform, see T. H. Smith, "Computers and the law of evidence", *Transnational Data Report*, vol. VI, No. 8 (December 1983), p. 451.

²¹One of the main purposes of Council of Europe Recommendation No. R (81) 20, 11 December 1981, was to establish uniform conditions under which original paper-based documents might be microfilmed or copied on computer and subsequently destroyed.

which are long enough for most problems to surface. The period of time recommended by the Council of Europe in Recommendation No. R (81) 20 was up to two years.²²

2. *Print-out as original or copy of computer record*

47. The record as stored in a computer in electronic form cannot be read or interpreted by a human being. Therefore, it cannot be presented to a tribunal unless it takes on a visual form, either on a visual display unit which the tribunal can see or on a print-out. According to the replies to the questionnaire, both means of presenting the data to the court are in use.²³

48. In a few States, the question has arisen whether the print-out or the image on the visual display unit is the original computer record or is a copy of the record stored in computer-readable form. In most States, this question seems either not to have arisen or the copy in human-readable form has been accepted on the grounds that the original record was not available to the court. Where this question has threatened to preclude the presentation of computer records as evidence, the rules of evidence have been amended to provide that a print-out could be considered to be an original record.²⁴

III. Authentication

49. Authentication of a transaction document serves to indicate to the recipient and to third parties the source of the document and the intention of the authenticating party to issue it in its current form. In case of dispute, authentication provides evidence of those matters. Although an authentication required by law must be in the form prescribed, an authentication required by the parties can consist of any mark or procedure they agree upon as sufficient to identify themselves to one another.

50. The most common form of authentication required by law is a signature. Signature is usually understood to mean the manual writing by a specific individual of his name or initials. A manual signature is personal to the individual signing and it cannot properly be made by any other person.

51. The demands of modern commerce have led many legal systems to permit required signatures to be made by stamp, symbol, facsimile, perforation or by other mechanical or electronic means. This trend is most evident in the law governing transport of goods, where all the principal multilateral conventions which require a signature on the transport document permit that signature to be made in some way other than by

manual signature.²⁵ One reply to the questionnaire indicated that there was a general rule in the commercial law of that State that a document may be "signed" by the use of any symbol executed or adopted by a party with the present intention of authenticating a writing. However, the reply also indicated that there were numerous exceptions to this general rule.²⁶

52. Various techniques have been developed to authenticate documents which have been transmitted electronically. Telex and computer-to-computer telecommunications often employ call-back procedures and test keys to verify the source of the message. Certain encryption techniques authenticate the source of a message and usually verify the content of the message as well. Remote access to a computer may require use of a password or the use of a magnetic stripe or microcircuit plastic card and a personal identification number (PIN) or password. Other techniques for authentication of electronic documents, such as electronic analysis of signatures, fingerprints, voice patterns and eye patterns are in various stages of development.

53. One technique which is often used when electronic documents are transmitted by the physical delivery of magnetic tapes or other computer memory devices is for the sending party to supplement any electronic authentication which may be on the memory device with a signed writing. Where the memory devices are physically delivered to the recipient of the documents, the addition of a signed writing adds little inconvenience or cost.

54. Although an individual document sent by telecommunications can be confirmed by a subsequent signed writing, as has been a customary practice in regard to telegrams and telex, in many cases that would defeat the purpose of computer-to-computer telecommunications. However, two parties who anticipate communicating frequently by computer-to-computer telecommunications may agree in writing beforehand on the form of the communications and the means to be used to authenticate the documents. Such an agreement may also be required by an administrative organ of the State before it will accept documents in electronic form, whether by telecommunications or computer memory device.²⁷ This signed agreement may be considered to supply any signature which is required

²²"Co-ordination of work: international transport documents: report of the Secretary-General" (A/CN.9/225), para. 47.

²³Reply of the United States. Also see para. 32 of the ECE document cited in footnote 24, above.

²⁴In its reply to the Customs Co-operation Council (CCC) document no. 31.678, cited in footnote 5), Denmark stated that before being permitted to submit information to the customs authorities by means of magnetic tapes or diskettes, the consignee must obtain an authorization from the authorities:

"34. Such authorization states exactly that the permission to submit clearance information by means of magnetic tapes or diskettes is subject to the condition that in all respects the same validity in law is attributed to the information as if the information were submitted by means of a signed Customs declaration.

"35. This implies that by accepting an authorization a consignee has 'signed' all the clearance information which he submits by means of magnetic tape or diskettes, and the arrangement is thus within the framework of the legislation in force."

²⁵Council of Europe recommendation No. R (81) 20, appendix, art. 1, para. 2, 11 December 1981.

²⁶Annex, questions 2 and 3.

²⁷Reply of the United States. Also see the report of the United States on the legal aspects of electronic interchange of data, submitted to the ECE/UNCTAD Working Party on Facilitation of International Trade Procedures (TRADE/WP.4/R.298/Rev.1), in particular para. 28.

by law. Nevertheless, any authentication of the computer-readable document itself would be in electronic form.

55. Although a manual signature is a familiar form of authentication and serves well for transaction documents passing between known parties, in many commercial and administrative situations it is relatively insecure. The person relying on the document often has neither the names of persons authorized to sign nor specimen signatures available for comparison. This is particularly true of many documents relied upon in foreign countries in international trade transactions. Even where a specimen of the authorized signature is available for comparison, only an expert may be able to detect a careful forgery. Where large numbers of documents are processed, signatures are sometimes not even compared except for the most important transactions.

56. Electronic forms of authentication using computers offer one major advantage over visual comparison of manual signatures. The procedure is so relatively inexpensive that every authentication can be verified as a routine matter. There is no need to restrict verification to the most important transactions.

57. If the proper procedures are followed, some authentication techniques in current use for computer-to-computer messages are unlikely to be used successfully by unauthorized persons. There are encryption techniques available which also serve to authenticate a message and which cannot be deciphered in a commercially significant period of time. Microcircuit cards perform the authentication procedure within an area of the microcircuit chip which cannot be reached from the outside. Therefore, it is expected that once these cards are in widespread use, they will offer a highly secure form of authentication of the person who used the card.

58. The legal problem, therefore, rests primarily with those laws which state that a document must be "signed". Where it is not possible to interpret the law so as to consider an electronic form of authentication as a "signature", it may be desirable either to indicate in the law that an electronic form of authentication is a "signature" or to permit documents to be "authenticated" by electronic means.²⁸

²⁸The ECE/UNCTAD Working Party on Facilitation of International Trade Procedures, in its Recommendation No. 14 ("Authentication of trade documents by means other than signatures", TRADE WP.4/INF.63), adopted at its ninth session in March 1979.

Recommends to Governments and international organizations responsible for relevant intergovernmental agreements to study national and international texts which embody requirements for signature on documents needed in international trade and to give consideration to amending such provisions, where necessary, so that the information which the documents contain may be prepared and transmitted by electronic or other automatic means of data transfer, and the requirement of a signature may be met by authentication guaranteed by the means used in the transmission; and

Recommends to all organizations concerned with the facilitation of international trade procedures to examine current commercial documents, to identify those where signature could safely be eliminated and to mount an extensive programme of education and training in order to introduce the necessary changes in commercial practices."

IV. Requirement of a writing

59. Legal rules which require the existence of a document for the validity of a transaction or to evidence that transaction, or which require the maintenance of certain chronological or summary records of the enterprise, often state that those documents or other records must be in writing. Since until recently the records of an enterprise were of necessity kept in paper-based form, the requirement of a writing was considered to be synonymous with the requirement of a paper-based document or other record. However, with the development of computers and computer-to-computer teletransmission of documents, the purpose of a legal requirement that there be a document or other record may as well be satisfied by the existence of a computer record.

A. Evidence

60. As noted in part II of this report, in most legal systems there are no major obstacles to the use of computer records as evidence. Therefore, where a document is required primarily to facilitate subsequent proof of the existence of the transaction and its terms, a document in computer-readable form would often be sufficient.

61. Where the document is of a nature that it can be stored only in the computer of one of the parties, a paper-based copy or receipt may be desirable. Such a receipt is required, for example, by Montreal Protocol No. 4 (1975) to amend the Convention for the Unification of Certain Rules relating to International Carriage by Air (Warsaw 1929), article 5 (2), which provides that if, in place of issuing an air way-bill, the carrier has used another means which would preserve a record of the carriage to be performed, "the carrier shall, if so requested by the consignor, deliver to the consignor a receipt for the cargo permitting identification of the consignment and access to the information contained in the record preserved by such other means." However, a receipt may not always be necessary. Many States do not require a bank to issue a receipt to a customer using an automatic cash dispenser or automatic teller machine on the grounds that the records of a bank can be expected to be accurate in this regard and the cost of furnishing a paper receipt would be excessive.

B. Awareness of consequences

62. Creation of a document to consummate a transaction may make the parties more aware of the legal and economic consequences of their act by causing them to be more specific about the transaction than they otherwise would be. Oral agreements or agreements arising out of conduct of the parties may be ambiguous as to whether one or both parties intended to enter into an agreement and whether they understood the terms of that agreement. Nevertheless, many agreements of this type are enforced, although other agree-

ments require the creation of a document or a contemporaneous confirmation of the transaction in documentary form.

63. The form which a document should take to fulfill this function would seem to be of little importance as long as the actions required of the parties create an awareness that legal consequences will arise out of those actions. The sending of a computer-to-computer message is as likely to bring about such awareness as is the sending of a letter or a telex, even though the computer-to-computer message does not necessarily result in a paper print-out at either the point of sending or the destination. Similarly, the authorization of a funds transfer by inserting a magnetic stripe or micro-processor card into a bank terminal and entering a personal identification number (PIN) or a password would necessarily make the transferor aware that legal consequences will follow from those acts.

C. Third-party reliance

64. Some of the most important commercial documents are specifically designed for the reliance of third parties on them. Such documents include negotiable instruments and documents of title, inspection and weight certificates and airline passenger tickets authorizing passage on more than one carrier. Because of the wide variety of such documents in existence, it is difficult to generalize as to the extent to which they are required by law. It may be the case that they are largely required by commercial parties for commercial reasons or, if required by law, they are required in order to permit the State to verify the details of the transaction for purposes of taxation, import controls, exchange control or for other regulatory reasons. Undoubtedly, however, the use of some documents of this type is required by law for the protection of third parties.

65. In regard to a number of transactions which traditionally called for the use of documents on which third parties could rely, satisfactory electronic substitutes have been devised. Where the use of such documents had not been required, the new procedures could be instituted without changes in the law. Therefore, cheques and paper-based payment orders have been replaced by electronic funds transfers, and in some trades bills of lading have been replaced by sea way-bills or electronically transmitted shipping documents, all without legislative activity. However, in some States where the law required the issuance of paper-based share certificates, bonds and other investment securities, their replacement by electronic registers required authorizing legislation.²⁹

66. In regard to a number of other transactions, satisfactory electronic procedures have not as yet been devised. The most frequently mentioned example is that, to date, it is not possible to effect a letter of credit

transaction without accompanying paper documentation. However, as solutions are found to the existing technical and commercial problems in respect of these transactions, legal provisions requiring the use of documents in paper-based form on which third parties can rely may become unnecessary.

D. Subsequent audit

67. All countries require enterprises to maintain certain records and the supporting documentation for the purpose of permitting a subsequent audit of the activities of the enterprise. In a few cases, the subsequent audit may be performed by private parties with an interest in the matter, such as shareholders of an enterprise who may have a right to have the conduct of the management audited. In most cases, the subsequent audit is undertaken by the State for purposes of taxation or to verify conformity with various regulatory controls.

68. It appears from the replies to the questionnaire that most rules on the form in which records must be maintained by enterprises concern chronological and summary records.³⁰ The traditional legal rules as to required accounting practices may include such matters as that the pages must be bound together and numbered.³¹ States with rules such as these which clearly required a paper-based form have had to change those rules by legislative or administrative action in order for enterprises to maintain their records on computers.³² Where such action has not been taken, the specified records of an enterprise must continue to be maintained on paper. It was not clear from the replies to the questionnaire to what extent transaction documents are required to be in paper-based form in order to facilitate later audit. To the extent they are, the same conclusion would seem to apply.

69. Requirements that original paper-based documents must be retained for a certain period of time even though they have been microfilmed or recorded on computer also have as one purpose the possibility of subsequent audit. In Sweden, the Accountancy Act permits the use of punched cards, punched tape, magnetic tape or other material from which a print-out or microfilm can be produced, but these means may not

²⁹Annex, question 8.

³⁰For example, Norway, in reply to the questionnaire, included the English translation of an extract from article 6 of the country's Accounting Act of 13 May 1977:

"The records [cash book, daily ledger, account ledger, general ledger, financial statement ledger] are to be maintained in a proper and clear manner. The records are to be bound or stitched and the pages or the leaves must be accurately numbered before the records are taken into use. Leaves must not be removed from bound or stitched books. The recording of the records must take place in a lasting manner. What has been recorded must not be crossed out or in any other way made unreadable."

³²Pursuant to the Accounting Act, regulations have been issued in Norway regarding the replacement of traditional records and vouchers by computer-readable ones. Several other replies also indicated that relevant legislation had been amended to provide specifically for keeping business records in computer-readable form.

²⁹In reply to question 8, Finland indicated that according to a provision in the Limited Companies Act, the stock register as well as the shareholders' register may be compiled through automatic data processing or other means.

be used for general ledger summaries or simultaneously for both vouchers and books of original entry.³³

E. Documents submitted to Governments

70. Although most replies to the questionnaire indicated that there were no general legal rules prohibiting the administration from accepting data or documents in computer-readable form, it appears that at present in no State are a wide range of computer-readable documents submitted to the Governments.³⁴ The most commonly reported were tax declarations of various types, including goods declarations to the customs authorities.

71. It is likely that so few computer-readable documents are accepted by Governments for a combination of administrative and legal reasons. In order to transmit any document in computer-readable form from one entity to another either by physical exchange of computer memory devices or by telecommunications, both parties must have compatible equipment capable of sending and receiving data in that form. Therefore, until the ministry concerned has acquired the necessary equipment and established the necessary procedures, it will continue to require that documents are submitted to it in paper-based form. This problem is particularly significant where the document must be received and acted upon in decentralized locations, such as customs entry points.

72. There appear to be a number of laws or regulations requiring specific documents to be in paper-based form.³⁵ Although these laws and regulations could presumably be easily amended, any ministry contemplating the acceptance of documents in computer-readable form will wish to be assured that the change in procedures will create no new legal problems. The potential legal problems are essentially the same as those faced by enterprises in their dealings with one another, i.e. that the record as received by the administration and stored in its computer will be accepted in case of dispute as a faithful record of the documents transmitted to it by the enterprise and that, in case of difficulties, the authentication of the electronic message to it from the enterprise will be legally sufficient to establish responsibility.

V. Legal value of computer records in international trade

73. The replies to the questionnaire show that countries on all continents and at every level of economic development have made changes in their law to give increased legal security to computer records. Although these changes in the law concern primarily domestic transactions, the problem of legal security of

computer records is of special importance in international trade.

74. The export and import of goods require a large number of documents. While the figures vary from one State to another, and to some extent on the type of goods and financing of the transaction, it is not unusual for an exporter to prepare over 100 different documents for each shipment. These documents must be prepared accurately and promptly so that neither the shipment nor payment is delayed. Furthermore, since some of the documents required for the import of the goods must be prepared in the country of export, there is a great interest in being able to use modern means of telecommunication to eliminate the delays inherent in the sending of paper-based documents through the mails.

A. Computer records as evidence

75. It appears from the replies to the questionnaire that the rules of evidence regarding computer records should not be a major obstacle to the use of computers or to the development of domestic or international computer-to-computer transmission of data or documents. Almost all of the countries that replied to the questionnaire appeared to have legal rules which were at least adequate to permit the use of computer records as evidence and to permit the court to make the evaluation necessary to determine the proper weight to be given to the data or document. The most important differences in the rules reflect differences in the law of evidence which are also applicable to paper-based documents but which have caused no noticeable harm to the development of international trade.

76. Nevertheless, evidentiary questions are of legitimate concern. In a very few States, computer records cannot be used as evidence. In at least one State, there is doubt whether a message stored in one computer which has been received from another computer in computer-readable form can be used as evidence. Other obstacles to the use of computer records as evidence exist as a result of the particular words of the relevant legislation or because of technological developments.

77. Furthermore, and perhaps of greater importance, there is a widely felt sense of insecurity over the perceived inadequacies in the law governing the use of computer records as evidence. This sense of insecurity may be in its own right an inhibition to the development of new patterns of trade documentation based on computers.

78. Therefore, it appears of greatest importance that there be an assurance that records from well-managed systems, including those using the most advanced technology, will be acceptable as evidence in courts. However, to obtain such assurance it seems neither advisable nor necessary to attempt to unify the rules of evidence regarding the use of computer records in international trade. The principal reasons are that the existence of traditional differences among systems of adjudication, to which the rules of evidence are closely

³³Reply of Sweden to question 8.

³⁴Annex, questions 10 and 11; also see Customs Co-operation Council document no. 31.678, cited in footnote 5, above.

³⁵Several of the replies to the questionnaire indicated the existence of such rules (annex, question 11).

tied, do not allow for a single approach and that the experience in regard to the rules of evidence as they apply to the paper-based system of documentation has shown that substantial differences in the rules themselves have caused no noticeable harm to the development of international trade.

B. *Authentication and requirement of a writing*

79. A more serious legal obstacle to the use of computers and computer-to-computer telecommunications in international trade arises out of requirements that documents be signed or that documents be in paper-based form.

80. Because of the central role of the customs services in the import and export of goods, it is particularly significant that several of them are currently prepared to accept goods declarations in computer-readable form and that several others have plans to begin accepting declarations in that form in the near future. This development may encourage other administrative services to do likewise, leading to a general relaxation of legal requirements that documents must be in writing or manually signed.

Conclusion

81. On the basis of the foregoing, the Commission may wish to conclude that the developments in the use of automatic data processing in international trade have reached such a stage as to justify a concerted international call to Governments to adapt their legal systems in the light of these new developments.

82. Should the Commission so agree, it may wish to consider adopting a recommendation on the basis of the following draft text:

The United Nations Commission on International Trade Law,

Noting that the use of automatic data processing (ADP) is already firmly established throughout the world in many phases of domestic and international trade as well as in administrative services,

Noting also that legal rules based upon pre-ADP paper-based means of documenting international trade may create an obstacle to such use of ADP in that they lead to legal insecurity or impede the efficient use of ADP where its use is otherwise justified,

Noting further with appreciation the efforts of the Council of Europe, the Customs Co-operation Council and the United Nations Economic Commission for Europe to overcome obstacles to the use of ADP in international trade arising out of these legal rules,

Considering at the same time that there is no need for a unification of the rules of evidence regarding the use of computer records in international trade, in view of the experience showing that substantial

differences in the rules of evidence as they apply to the paper-based system of documentation have caused so far no noticeable harm to the development of international trade,

Considering also that the developments in the use of ADP are creating a need in many legal systems for an adaptation of existing legal rules to these developments, having due regard, however, to the need to encourage the employment of such ADP means that would provide the same or greater reliability as paper-based documentation,

1. *Recommends to Governments;*

(a) to review the legal rules affecting the use of computer records as evidence in litigation in order to eliminate unnecessary obstacles to their admission, to be assured that the rules are consistent with developments in technology, and to provide appropriate means for a court to evaluate the credibility of the data contained in those records;

(b) to review legal requirements that certain trade transactions or trade-related documents be in writing, whether the written form is a condition to the enforceability or to the validity of the transaction or document, with a view to permitting, where appropriate, the transaction or document to be recorded and transmitted in computer-readable form;

(c) to review legal requirements of a handwritten signature or other paper-based method of authentication on trade-related documents with a view to permitting, where appropriate, the use of electronic means of authentication;

(d) to review legal requirements that documents for submission to Governments be in writing and manually signed with a view to permitting such documents to be submitted in computer-readable form to those administrative services which have acquired the necessary equipment and established the necessary procedures;

2. *Recommends to international organizations* elaborating legal texts related to trade to take account of the present Recommendation in adopting such texts and, where appropriate, to consider modifying existing legal texts in line with the present Recommendation.

ANNEX

Analytical summary of replies to UNCITRAL questionnaire on use of computer-readable data as evidence in court proceedings

Replies to the questionnaire were received from the following States: Australia, Austria, Burma, Canada, Chile, Colombia, Czechoslovakia, Denmark, Dominican Republic, Finland, Germany, Federal Republic of, Honduras, Hungary, Iraq, Japan, Luxembourg, Mexico, Nigeria, Norway, Philippines, Portugal, Senegal, Sweden, Tonga, United Kingdom of Great Britain and Northern Ireland, United States of America, Venezuela, Yugoslavia, Zambia (29 replies).

Use of computer-readable data in court proceedings

A. Records stored in computer-readable form

Question 1

Can a record of a transaction which is or has been stored in a computer or in a computer-readable form (e.g. magnetic tape, disk or the like) be admitted in evidence in civil, criminal and administrative court proceedings? If the courts in your country generally admit in evidence all data deemed to be relevant to the dispute, leaving it to the finder of fact (judges or jury) to weigh its significance, please answer this question by so stating.

Summary of replies

The replies of many States show that their law of evidence is based on a general principle according to which all relevant data, regardless of their form, are admissible in evidence and, therefore, there is no obstacle to the introduction in evidence of a record which is or has been stored in a computer or in a computer-readable form. In these legal systems, it is left to the court to freely weigh the credibility of computer records in the light of all circumstances (Austria, Colombia, Czechoslovakia, Denmark, Finland, Germany, Federal Republic of, Honduras, Japan, Mexico, Norway, Portugal, Sweden, Yugoslavia, Zambia). However, some of these replies note that a computer record, where it reproduces the content of a document, may be regarded as a copy with the consequence that the court may require the production of the document on the ground that it is more reliable evidence (Austria, Finland, Sweden).

According to other replies, characteristic for legal systems of the common law tradition, computer records are admissible under the condition that certain foundation facts are established. These foundation facts are generally related to the method and equipment used in the preparation of the computer record and should show preliminarily that the record may be credible (Australia (some jurisdictions), Philippines, United Kingdom, United States), although in some legal systems it may be sufficient to show that the computer records were maintained in the usual or ordinary course of business (Australia (some jurisdictions), Canada). (Conditions for the admissibility of computer records are dealt with under question 4, below.) The provisions on weight of computer records as contained in some of the common law rules of evidence (Australia, United Kingdom) indicate that a computer record admitted in evidence is weighed by the common law court or jury basically in the same way as in the legal systems where in principle all evidence is admitted.

The third group of replies is from the States where the evidentiary rules contain an exhaustive list of acceptable evidence and, since computer records are not dealt with in these rules, a computer record is considered either as not admissible (Burma, Chile, Dominican Republic) or not acceptable as an independent evidence, i.e. a computer record can only be relied upon in connection with other admissible evidence (Luxembourg, Senegal, Venezuela). However, in some of these States there are no restrictions as to the admissibility of evidence, including computer-stored evidence, in commercial cases (Luxembourg, Senegal), in civil cases in which the value of the disputed subject-matter does not exceed the amount fixed by statute (Luxembourg, Senegal, Venezuela), or in criminal cases (Luxembourg, Senegal, Venezuela).

Several replies indicated that reforms in the law relative to the use of computer records as evidence were under active

consideration (Chile, Germany, Federal Republic of, Hungary, Luxembourg, United Kingdom).

Question 2

If the court would accept as evidence a record of a transaction which is or has been stored in computer-readable form, would the court accept the record in computer-readable form or would it require a print-out or other human-readable output medium?

Summary of replies

According to some replies, for a computer record to be acceptable in evidence it is required that it be presented to the court in a print-out or other human-readable output medium (Denmark, Philippines, Senegal, Sweden, United Kingdom, Zambia). According to other replies, the way of presenting a computer record to the court may be more flexible. While in some legal systems the interpretation is that the court might be willing to accept a record in computer-readable form provided that it can be made understandable to the court (Austria, Canada, Colombia, Czechoslovakia, Honduras, Mexico, Norway, Portugal, Tonga, United States), there are legal systems which expressly permit a record to be presented to the court by a video display unit or in other form that can be understood by sight (Australia (some jurisdictions), Finland, Germany, Federal Republic of).

Question 3

If the court required a print-out or other human-readable output medium, would it accept a print-out produced for the purposes of the court proceedings or would it require a print-out produced at the time the computer record of the transaction was created?

Summary of replies

It appears that in the States which replied to the question there are no explicit provisions on the time at which a print-out must have been made and that the replies are based on an interpretation of rules of evidence. Under two replies, the print-out should have been made at the time the record was created (Philippines (for import goods declarations), Zambia). Under other replies, the court will not necessarily refuse to accept a computer print-out only because it has been produced some time after the record has been created or because it has been produced for the purposes of the court proceedings (Australia, Canada, Colombia, Czechoslovakia, Denmark, Finland, Germany, Federal Republic of, Honduras, Japan, Mexico, Norway, Sweden, Tonga, United Kingdom, United States). Some of these latter replies point out that the time of the making of a computer print-out influences the evidential weight to be given to it and that the court may require the submission of an earlier print-out if it exists or it may require the party to establish that the presented print-out corresponds to the original computer record, i.e. that the computer-readable record has not been altered after it was created (Canada, Finland, Germany, Federal Republic of, Senegal, Sweden).

Question 4

What conditions would have to be satisfied prior to the admissibility in evidence of a record stored in computer-readable form or, if all relevant data are admissible in your country, to assure that it was treated by the court as having equivalent weight to similar data submitted in written form?

Summary of replies

Legal systems which indicate in their replies that all relevant data are admissible in evidence do not provide conditions for a computer record to have equivalent weight to similar data submitted in documentary form. It is left to the court to evaluate the weight of the computer record depending upon all circumstances of the case (Austria, Colombia, Czechoslovakia, Denmark, Finland, Germany, Federal Republic of, Honduras, Japan, Mexico, Norway, Sweden, Yugoslavia). The same appears to apply for the cases where computer records are admissible by way of exception (Luxembourg, Senegal, Venezuela).

In legal systems where rules like the "hearsay evidence" rule limit the admissibility in evidence of a computer record, conditions were laid down under which the record would be admissible. These legal conditions could be summarized as dealing with the following issues: (a) the expectation that the computing equipment was functioning properly, (b) the time and the reliability of the method of making computer entries and (c) the sources of information on the basis of which the computer record was made (Australia (some jurisdictions), Philippines, United Kingdom, United States). In a few common law legal systems, business records kept on computers are normally admitted in evidence and the above-mentioned conditions are used to determine the weight of the evidence (Australia (some jurisdictions), Canada (unsettled as to conditions for admission)).

Question 5 (a)

Do the courts in any circumstances accept an authentication of a computer-readable record where the authentication is in electronic form?

Summary of replies

In many legal systems, authentication in electronic form would be acceptable (Austria, Czechoslovakia, Denmark, Finland, Honduras, Mexico, Norway, Sweden, United States, Zambia). This position is based either on legal rules dealing with authentication by means other than a handwritten signature or, more frequently, on an interpretation of the rules giving discretion to the court in admitting and assessing evidence. However, in some of these legal systems the electronic authentication would be acceptable only if legal rules do not require a written document for the transaction (Austria, Denmark, Finland, Norway). For other legal systems, it appears that the courts would not accept an electronic authentication in any circumstances (Colombia, Germany, Federal Republic of, United Kingdom). There is also a flexible approach according to which an authentication is accepted in such form as the court may approve and this may also include the authentication in electronic form (Australia).

Question 5 (b)

If a "signature" is required by statute or other legal rule, would the courts accept a "signature" made in electronic form or would they require the signature to be on paper?

Summary of replies

If a signature is required by statute or other legal rule, many replies indicate that only a paper-based authentication meets the requirement (Austria, Chile, Colombia, Czechoslovakia, Denmark, Germany, Federal Republic of, Finland, Honduras, Japan, Mexico, Norway, Philippines, Senegal, Sweden, Zambia).

slovakia, Denmark, Germany, Federal Republic of, Finland, Japan, Luxembourg, Norway, Tonga, United Kingdom) and, as stressed by some of these replies, the only acceptable authentication is a handwritten signature (Austria, Finland, Honduras, Senegal). Under other replies, a "signature" in electronic form may be accepted as a substitute for a paper-based authentication (Mexico, Sweden, United States, Zambia).

B. Records transmitted in computer-readable form

Question 6

If the data were entered and originally processed on the computer of one firm and subsequently transmitted to the computer of a second firm in computer-readable form (i.e. by teletransmission of the data or by manual transfer of a magnetic tape or other similar data carrier), would the data as stored in the computer of the second firm be less acceptable as evidence than the data as stored in the computer of the first firm?

Summary of replies

According to most replies, the sole fact that data have been transmitted, either by teletransmission or by manual transfer of a data carrier, does not make the data as stored in the computer of the second firm less acceptable than the data as stored in the computer of the first firm (Austria, Colombia, Czechoslovakia, Denmark, Finland, Germany, Federal Republic of, Honduras, Japan, Mexico, Norway, Philippines, Senegal, Sweden). However, some of these replies point out that the evidential weight of the data stored in the computer of the second firm would depend on the circumstances of the case such as the extent of precautionary measures taken against the risk of alteration of data during transmission.

With regard to the common law legal systems where computer records are made admissible by specific rules, according to one reply a computer record received from a computer of another firm would probably not be admissible (United Kingdom). Other replies show that a transmission of data does not necessarily affect the admissibility of the record received in such a way (Australia, Canada, Zambia). According to these latter replies, a computer record received from a computer of another firm can be made admissible in different ways. For example, the record may be admissible if it is treated as a copy and meets the conditions for the admissibility of copies (e.g. that it is not possible or reasonably practicable to produce the original record or by leave of court) or if it is shown that the data were transmitted in the ordinary course of business or if the computers between which the transmission was effected are treated as one computing system.

Question 7

Would any conditions additional to those called for in question 4 be required to be met?

Summary of replies

Provided that the proponent establishes the integrity of the process of transmission, legal systems do not require any additional conditions to be met (Australia, Austria, Canada, Czechoslovakia, Denmark, Finland, Germany, Federal Republic of, Honduras, Japan, Mexico, Norway, Philippines, Senegal, Sweden, Zambia).

C. Business records and submission of required documents

Question 8

Are there any legal rules relevant to commercial activity in general which would prohibit a commercial firm from keeping all of its records in computer-readable form? (Such legal rules might include corporation laws prescribing the nature and form of corporate records or taxation statutes prescribing the type of records which must be available for audit.)

Summary of replies

According to some replies, there are no rules relevant to commercial activity in general which would prohibit a commercial firm from keeping all of its records in computer-readable form (Australia, Austria, Colombia, Honduras, Japan, Mexico, Tonga, United Kingdom, United States, Zambia). According to other replies, a company has a right to choose the form of its books with the exception of certain enumerated books or parts of books that are to be kept in writing (Canada, Denmark, Czechoslovakia, Finland, Germany, Federal Republic of, Portugal, Senegal, Sweden). The exceptions concern, for example, the annual financial statement (Denmark, Finland, Germany, Federal Republic of, Sweden), minutes of the shareholder's meeting (Finland), records of the company's stock (Finland, Germany, Federal Republic of) or simultaneous keeping of books of original entry and the documentation supporting the entries (Sweden). According to two replies, the competent administration may give permission for parts of the business records to be kept in computer-readable form after being assured of the reliability of the computing system and of the necessary references between entries and the supporting documentation (Finland, Norway).

Question 9

If a commercial firm is required to keep certain records in written form, is the requirement satisfied by a print-out from a record originally stored in a computer? If so, are there any rules as to the period of time after the entry of the data into the computer within which the print-out must be made (i.e. must the print-out be made within the same day, week, month or year)?

Summary of replies

According to some replies, the requirement to keep certain records in written form is not satisfied by a print-out from a record originally stored in a computer (Czechoslovakia, Germany, Federal Republic of, Portugal, Senegal). The ground given in one reply is that data could have been manipulated before the making of the print-out (Senegal). According to other replies, a computer print-out will generally satisfy the requirement, either as such (Norway, Honduras) or provided that it is signed (Finland).

As to the second part of the question relating to the period of time between the entry of the data into the computer and the making of the print-out, the replies indicate either that there are no rules on the point (Finland, Honduras, Zambia) or that the print-out must be made within the period of time considered to be in conformity with the principles of good accountancy (Norway).

Question 10

Does the administration accept any data or documents from commercial parties in computer-readable form? If so, please indicate some of the more important categories of data or documents which are so accepted.

Summary of replies

Besides the customs administrations (as reported in document 31.678 of the Customs Co-operation Council of 10 August 1984), tax and social security administrations appear to be the most willing to accept certain types of data in computer-readable form (Canada, Finland, Honduras, Norway, Senegal, United Kingdom, United States). Such data are related, for example, to declarations of taxable goods or transactions (Canada, Senegal, Norway) or to social security contributions (Senegal, United Kingdom). In addition, statistical data (Canada, Czechoslovakia, Finland) and data relating to certain transactions, including exports and imports, for the purposes of planning or pursuing the fulfillment of a plan were mentioned (Czechoslovakia).

Question 11

Is the administration prohibited by law from accepting from commercial parties some or all data or documents in computer-readable form? If so, please indicate some of the more important categories, especially among those relevant to international trade.

Summary of replies

According to most replies, there are no rules prohibiting the administration from accepting data or documents from commercial parties in computer-readable form (Australia, Austria, Canada, Czechoslovakia, Germany, Federal Republic of, Honduras, Mexico, Senegal, Tonga, United Kingdom, Zambia). Other replies, while indicating that there is no general prohibition for the administration to accept data in computer-readable form, state that there are cases where the administration may be prohibited from accepting data in such form (Finland, Norway, Portugal, United States). The prohibition may be the result of a rule requiring the commercial party to present a written and signed document (Finland, Norway, Portugal) or a rule on the protection of privacy of individuals restricting a commercial party to transfer computer-stored data to third parties including the administration (Norway).

VI. CO-ORDINATION OF WORK

Legal aspects of technology transfer: current activities of international organizations within the United Nations system: report of the Secretary-General (A/CN.9/269)^a

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^aFor consideration by the Commission, see *Report*, chapter VI, C (part one, A, above).

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Introduction

1. This report is one in the series of specialized reports on current activities of international organizations related to the harmonization and unification of international trade law. It deals with the activities undertaken by organizations within the United Nations system on the legal aspects of technology transfer and is based on documentation available as at 14 December 1984. The term "technology transfer" as conceived by various United Nations organizations covers a wide field and includes the transfer of systematic knowledge, skill and techniques from the supplier of technology for the manufacture of a product, the application of a process, or the operation and maintenance of works. This technology transfer can take place through, for example, know-how agreements, licensing agreements, joint ventures, turnkey or semi-turnkey contracts, or management contracts.

2. Work within the United Nations system has concentrated on technology transfer to developing countries. Some of the major problems which developing countries face in the import of technology are the high costs involved, the imposition of restrictive terms and conditions which may militate against economic and technological development, and the absence of certain important guarantees from the supplier pertaining to

the technology transferred. Some developing countries may lack experience in drafting technology transfer agreements. There is also a lack of an adequate legal framework in some developing countries for regulating the transfer of technology or conditions for its transfer.

I. Codes of conduct relating to technology transfer

A. UNCTAD draft international code of conduct on the transfer of technology

3. By resolution 74 (X) of 18 September 1970, the United Nations Conference on Trade and Development (UNCTAD) established an Intergovernmental Group on the Transfer of Technology, which initiated work on the formulation of an international code of conduct on the transfer of technology. By its resolution 32/188 of 19 December 1977, the General Assembly decided to convene, under UNCTAD auspices, a United Nations Conference on an International Code of Conduct on the Transfer of Technology with the mandate to negotiate on the draft international code of conduct on the transfer of technology (hereinafter referred to as the draft Code) and to take all decisions necessary for its adoption. The fifth session of the Conference was held in October/November 1983. The sixth session is scheduled for May 1985.

4. The draft Code consists of a preamble and nine chapters covering definitions and scope of application (chapter 1), objectives and principles (chapter 2), national regulation of transfer of technology transactions (chapter 3), restrictive business practices (chapter 4), responsibilities and obligations of parties (chapter 5), special treatment for developing countries (chapter 6), international collaboration (chapter 7), international institutional machinery (chapter 8), and applicable law and settlement of disputes (chapter 9).

5. The draft Code defines technology transfer as the transfer of systematic knowledge for the manufacture of a product, for the application of a process or for the rendering of a service and does not extend to transactions involving the mere sale or mere lease of goods.¹ Transactions involving technology transfer which are within the scope of the draft Code include sale and licensing of all forms of industrial property, provision of know-how and technical expertise and provision of technological knowledge necessary for the installation, operation and functioning of plant and equipment, and turnkey projects.²

6. The draft Code deals mainly with the conduct of suppliers and recipients of technology and seeks "to establish general and equitable standards on which to base the relationships among parties to transfer of technology transactions and governments concerned, taking into consideration their legitimate interests, and giving due recognition to special needs of developing countries for the fulfillment of their economic and social development objectives."³

7. By the close of the fifth session of the Conference, many provisions in the draft Code were resolved by the three Groups which negotiated on it, i.e. the Group of 77 (developing countries), Group B (developed market economy countries) and Group D (socialist countries). However, there were still some major issues to be resolved, including restrictive business practices, the responsibilities and obligations of the parties, and the settlement of disputes. The areas of agreement or substantial agreement, as well as the outstanding issues, are indicated below.

1. *Some major issues: areas of agreement or substantial agreement*

(a) *Some aspects of restrictive business practices*

8. Chapter 4 of the draft Code deals with restrictive business practices. The restrictive practices dealt with are those which are more commonly found in technology transfer agreements between enterprises from developed and developing countries. Agreement or substantial agreement has been reached on provisions dealing with the following restrictive practices (the

practices are listed in the general order in which they appear in chapter 4, B, of the draft Code).

Grant-back provisions

9. The draft Code seeks to avoid grant-back provisions, i.e. provisions which would require the acquiring party to grant back to the supplying party any improvements that are made to the acquired technology, in certain circumstances. All three Groups have agreed that grant-back provisions should be avoided when they would constitute an abuse of a dominant market position of the supplying party. The outstanding issue is whether such grant-back provisions should also be avoided, as proposed by Group B, when they are on an exclusive basis either without offsetting consideration or without reciprocal obligations from the supplying party. The Group of 77 proposes that they should be avoided when they are on an exclusive basis, when there is an absence of offsetting consideration, or when there is an absence of reciprocal obligations from the supplying party.

Challenges to validity of patents

10. Subject to the appropriate applicable law and the terms of the agreement to the extent consistent with that law, the draft Code seeks to avoid practices which require the acquiring party to refrain from challenging the validity of patents and other types of protection for inventions involved in the transfer or the validity of other such grants claimed or obtained by the supplying party. Group B proposes to qualify the provision by introducing the term "unreasonably" (a qualification hereinafter referred to as the "rule of reason", see para. 28, below).

Exclusive dealing

11. All three Groups have agreed that practices which restrict the freedom of the acquiring party to enter into sales, representation or manufacturing agreements relating to similar or competing technologies or products or to obtain competing technology should be avoided, when such restrictions would not be needed for ensuring the achievement of legitimate interests, particularly including securing the confidentiality of the technology transferred or best-effort distribution or promotional obligations.

Restrictions on research

12. The draft Code seeks to avoid practices which restrict the acquiring party either in undertaking research and development directed at adapting the transferred technology to local conditions or in initiating research and development programmes based on the transferred technology for the purpose of developing new products, processes or equipment (see para. 15, below). Group B and Group D propose that such restrictions should only be prohibited if they are unreasonable.

¹TD/CODE TOT/41, chap. 1, sect. 1.2. This is the most recent version of the draft Code.

²Ibid., chap. 1, sect. 1.3.

³Ibid., chap. 2, sect. 2.1 (i).

Restrictions on the use of personnel

13. The draft Code seeks to avoid practices which require the acquiring party to use personnel designated by the supplying party, except to the extent necessary to ensure an efficient transmission phase for the transfer of technology. The exception would, however, be subject to the condition that there is no adequately trained local personnel available. Group B proposes that such a requirement should only be prohibited if it is unreasonable.

Price fixing

14. The draft Code seeks to avoid practices which empower the supplying party to regulate prices to be charged by acquiring parties in the relevant market to which the technology was transferred for products manufactured or services produced using the technology supplied. Group B proposes that only price fixing which is unjustifiable should be prohibited (i.e. rule of reason).

Restrictions on adaptations

15. The draft Code seeks to avoid practices which prevent the acquiring party from adapting the imported technology to local conditions or introducing innovations to it (see para. 12, above). It also seeks to prohibit clauses obliging the acquiring party from introducing unwanted or unnecessary design or specification changes, unless the acquiring party makes adaptations on his own responsibility and without using the technology supplying party's name, trade or service marks or trade names. The restrictions would not apply if the adaptation would, for example, unsuitably affect those products produced by the transferred technology. Group B proposes to limit this provision to unreasonable restrictions.

Exclusive sales or representation agreements

16. All three Groups have agreed that practices which require the acquiring party to grant exclusive sales or representation rights to the supplying party or his nominees should be avoided, except in cases of sub-contracting or manufacturing arrangements where the parties have agreed that all or part of the production under the technology transfer arrangement would be distributed by the supplying party or any person designated by him.

Tying arrangements

17. The draft Code seeks to avoid practices which impose on the acquiring party the acceptance of additional technology, future inventions and improvements, and goods or services not wanted by the acquiring party as a condition for obtaining the technology required. However, tying arrangements should be allowed if the supplying party has a justifiable interest in imposing such arrangements, e.g. maintaining the quality of the product or service because of the acquiring party's use of a trade or service mark or other identifying item, or where the supplying party has to fulfil guarantees given to the acquiring

party. Group B proposes that such an imposition should be prohibited only if it unduly restricts the sources of technology, goods or services, as a condition for obtaining the technology required (i.e. rule of reason).

Patent pool or cross-licensing agreements and other arrangements

18. All three Groups have agreed that patent pool or cross-licensing agreements and other international transfer of technology interchange arrangements among technology suppliers which would unduly limit access to new technological developments or which would result in an abusive domination of an industry or market with adverse effects on technology transfer should be avoided. An exception is made for those restrictions appropriate and ancillary to co-operative arrangements.

Restrictions on publicity

19. The draft Code seeks to avoid practices which restrict advertising or publicity by the acquiring party in regard to the supplying party's trade or service marks, trade names or other identifying items except where restrictions of such publicity may be required to prevent injury to the supplying party's goodwill or reputation. Restrictions may be required, for example, where the advertising or publicity makes reference to the supplying party's name, or where appropriate for safety purposes, or when needed to secure the confidentiality of the technology transferred. Group B proposes that such restrictions should be prohibited only if they are unreasonable.

Payments and other obligations after expiration of industrial property rights

20. All three Groups have agreed that practices which require payments or imposition of other obligations for continuing the use of industrial property rights which have been invalidated, cancelled or which have expired should be avoided, "recognizing that any other issue, including other payment obligations for technology, shall be dealt with by the appropriate applicable law and the terms of the agreement to the extent consistent with that law".

(b) Responsibilities and obligations of parties

21. Chapter 5 of the draft Code deals with the responsibilities and obligations of the parties, both in the pre-contractual phase and in the contractual phase. With the exception of two,⁴ all provisions in this chapter have been agreed to by the three Groups. In the pre-contractual phase, i.e. when the parties are negotiating the technology transfer agreement, the draft Code directs the attention of the parties to matters such as the use of locally available resources (personnel, technologies, technical skills and other resources), the rendering of technical services in the introduction and

⁴The provisions on confidentiality in the contractual phase of transfer of technology agreements and on dispute settlement and applicable law (TD/CODE TOT/41, Chap. 5, sects. 5.4 (ii) and 5.4 (iii)).

operation of the technology to be transferred, "un-packaging" of technologies (i.e. a detailed disclosure of all the elements that make up the "package", with a separate assessment of the cost for each element), the need to agree on fair and reasonable terms and conditions, non-disclosures of confidential information received from a potential supplying party, and the supply of accessories, spare parts and components by the technology supplier.

22. In the contractual phase, the draft Code directs the attention of the parties to matters such as access to improvements to the technology transferred, maintenance of confidentiality in connection with the technology transferred, dispute settlement and applicable law, guarantee that the technology is suitable for manufacturing the goods or producing the services stipulated in the agreement, the rights of the supplying party to the technology transferred, and performance guarantees.

(c) *Legal form of the draft Code*

23. The question of the legal form of the draft Code may now be regarded as settled. At the end of the fifth session of the Conference, it appeared that the draft Code would be adopted in the form of a General Assembly resolution and that a conference to review the draft Code would be convened five years after its adoption.⁷ The Code would contain a follow-up machinery which would require States which have accepted the Code to take appropriate steps at the national level to meet their commitment to it.

2. *Some outstanding issues*

(a) *Some aspects of restrictive business practices*

Export restrictions

24. Agreement has not been reached among the three Groups on the imposition of export restrictions on exportable products produced from the technology supplied.⁸ The Group of 77 proposes a prohibition on all restrictions which would prevent or hinder export by means of territorial or quantitative limitations or prior approval for export or export prices of products or increased rates of payments for exportable products. Group B proposes that the prohibition be limited to unreasonable restrictions and that restrictions would be justified, for example, whenever the restriction refers to exports of such products to countries where they are protected by the supplying party's industrial property rights, or to countries where the relevant know-how has retained its confidential character, or where the supplying party has granted to another party a licence to use the relevant technology. Group D proposes a similar justification.

Restrictions after expiration of the arrangement

25. Group B and Group D propose to protect, after the expiration of the technology transfer arrangement,

existing industrial property rights as well as know-how which has not entered the public domain, whereas the Group of 77 proposes to forbid any restrictions on use after the agreement has expired or after the know-how has lost its secret character.⁹

Other proposals on restrictions

26. The Group of 77 and Group D propose six other provisions on restrictive business practices to be included in the draft Code. These deal with limitations on the volume or scope of production by the acquiring party, the use of quality controls by the acquiring party, the obligation to use trade marks, the requirement to provide equity or participate in management, unlimited or unduly long duration of arrangements, and limitations upon use of technology already imported by the acquiring party.

(b) *Criteria for application of restrictive business practices*

27. It is generally agreed by the three Groups that some criteria should govern the application of restrictive business practices in chapter 4. It has been suggested that, subject to the other provisions of the chapter, the draft Code should state that the restrictive business practices described in the chapter should be avoided in international transfer of technology transactions. It has also been suggested that whether a practice should be avoided in an individual case should depend on an evaluation of the overall purposes of the transaction, the effects of the parties on the economic and technological development of the acquiring country, the competitive situation in the relevant market, the interests of the parties, the situation prevailing at the inception of the arrangement, and all other relevant circumstances. It has also been suggested that restrictive business practices between related parties (i.e. between parent and subsidiary companies) should be evaluated in the light of their special relationship. These criteria have not been fully settled.¹⁰ The areas of disagreement are set forth below:

"Rule of reason" approach compared with "adversely hindering economic and technological development" approach

28. Restrictive business practices may have a tendency to restrict trade, or have an anti-competitive effect. Group B proposes to introduce the "rule of reason" (the use of such terms as "unreasonably", "unjustifiably" and "unduly") into some of the provisions of the draft Code (chapter 4, sections B2, 4-7, 9, 10 and 12). Under this approach, a case by case consideration is envisaged and a restrictive business practice is permitted if it is reasonable, justifiable, or if it is not unduly restrictive. The Group of 77 approach to judging restrictive business practices is based on whether such practices adversely affect the international flow of technology by, for example, hindering the economic and technological development of acquiring parties.

⁷Ibid., appendix A.

⁸Ibid., appendix D; see, also, TD/CODE TOT/38.

⁹Ibid., appendix D.

¹⁰Ibid., appendices A and D.

Commonly owned enterprises

29. Another issue concerns the transfer of technology between two companies in common ownership. The position of the Group of 77 is that practices and restrictions between commonly owned enterprises should be examined in the light of the rules, exceptions and factors applicable to all transfer of technology transactions. Such practices may be considered as not contrary to the provisions of the draft Code when they would otherwise be acceptable and would not adversely affect the transfer of technology.⁹ According to Group B, restrictions for the purpose of rationalization or reasonable allocation of functions between parent and subsidiary or among enterprises belonging to the same concern would normally be considered not contrary to the draft Code unless they constitute an abuse of a dominant position of market power within the relevant market, for example, unreasonable restraint of the trade of a competing enterprise.

(c) *Confidentiality*

30. The transfer of technology may require the disclosure of confidential information. Group B proposes that there should be respect for the confidentiality and proprietary nature, and the use only for the purposes and on terms stipulated in the agreement of any trade secrets, secret know-how and all other confidential information received from the other party in connection with the transfer of technology. The Group of 77 considers that confidentiality should not extend beyond an adequate lapse of time after the transmission of each item of secret information. Group D considers that this obligation should end after the trade secrets, secret know-how and other confidential information received have entered the public domain independently of the acquiring party. At the fifth session of the Conference, the text for consideration on the provision on confidentiality (chapter 5, section 5.4 (ii)) in the contractual phase of transfer of technology agreements was: "Maintenance of confidentiality including its scope and duration and the use of any assets like trade secrets, secret know-how and all other confidential information received from the other party in connection with the transfer of technology." No agreement was reached on this text.¹⁰

(d) *Definition of an "international" transfer of technology*

31. While it is clearly agreed that the draft Code applies to transactions across national boundaries, there is disagreement among the three Groups on the extent to which the provisions of the draft Code should apply to transactions within national boundaries that might have an international content.¹¹ Group B proposes that States could, by means of national legislation, apply the principles of the draft Code to technology transactions within their national boundaries. The Group of 77 and Group D propose that the draft Code should apply to transactions between parties

which reside or are established in the same country, if in the latter case at least one of the parties is directly or indirectly controlled by a foreign entity and the technology transferred has not been developed in the acquiring country by the supplying party.

(e) *Applicable law and settlement of disputes*

32. The text on applicable law and settlement of disputes, contained in chapter 9, has not been agreed. The elements that may be included in this chapter are choice of law, amicable way of settling disputes or differences between parties, resort to arbitration, encouragement of the use of internationally accepted rules of arbitration, such as the UNCITRAL Arbitration Rules, recognition and enforcement of arbitral awards.

B. UNCTC draft code of conduct on transnational corporations

33. Transnational corporations have been important agents in the generation, application and international transfer of technology. Much of the technology relevant for the economic and industrial development of developing countries belongs to transnational corporations. Work by the United Nations Commission on Transnational Corporations (UNCTC) on a draft United Nations code of conduct on transnational corporations (hereinafter referred to as the UNCTC draft Code) is still in progress.¹²

34. The UNCTC draft Code is to consist of six main parts. The first part, which has not yet been drafted, is to contain a preamble and a statement of objectives. The second part consists of a set of provisions on definitions and scope of application. The third part deals with the activities of transnational corporations and specifies the kinds of conduct that are deemed permissible. The fourth part deals with the treatment that transnational corporations are to receive from the Governments of the countries in which they operate. The fifth part addresses the necessary co-operation among Governments for the application of the draft Code, while the sixth part deals more specifically with the action needed at the national and international levels for the implementation of the draft Code.

35. The Intergovernmental Working Group on the Code of Conduct, and the Commission on Transnational Corporations at its special session held in June 1984, agreed that the UNCTC draft Code should deal, in an appropriate manner, with competition and restrictive business practices, and transfer of technology.¹³ It was agreed that, in so far as competitive and restrictive business practices were concerned, the following formula would be appropriate:¹⁴

"For the purposes of this Code, the relevant provisions of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices adopted by the General Assembly

⁹*Ibid.*, appendix D.

¹⁰*Ibid.*, appendix A.

¹¹*Ibid.*, chap. 1, sect. 1.4; see, also, appendices A and C.

¹²E/C.10/1982/6.

¹³E/C.10/1984/5, paras. 61-63, E/C.10/1984/5.

¹⁴*Ibid.*, para. 62.

in its resolution 35/63 of 5 December 1980 shall/should also apply in the field of restrictive business practices." (See section II, below.)

36. Agreement has not been reached on the manner in which the UNCTC draft Code should deal with the question of transfer of technology. One suggested proposal is to include substantive provisions reflecting three ideas.¹⁵ First, transnational corporations should conform to the transfer of technology laws and regulations of the countries in which they operate and co-operate with the competent authorities of those countries in assessing the impact of international transfers of technology on their economies and also consult with them regarding the various technological options which might help those countries, particularly developing countries, to attain their economic and social development. Secondly, transnational corporations in their transfer of technology transactions, including intra-corporate transactions, should avoid practices which adversely affect the international flow of technology or otherwise hinder the economic and technological development of countries, particularly developing countries. Thirdly, transnational corporations should contribute to the strengthening of the scientific and technological capacities of developing countries. Transnational corporations should also undertake substantial research and development activities in developing countries and make full use of local resources and personnel in this process.

37. Another proposal is to adopt the relevant provisions of the UNCTAD draft Code (see section A, above), with the following formula: "For the purposes of this Code the relevant provisions of the International Code of Conduct on the Transfer of Technology adopted by the General Assembly in its resolution . . . of . . . shall/should apply in the field of transfer of technology."

II. Declaration of principles and rules on restrictive business practices

38. The General Assembly, by its resolution 35/63 of 5 December 1980, adopted the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (hereinafter referred to as the Set of Principles and Rules). While the Set of Principles and Rules does not make specific reference to technology transfer, a number of these Principles and Rules could be regarded as relevant to technology transfer. Part IV, section D of the Set of Principles and Rules provides that enterprises should refrain from certain acts or behaviour in a relevant market when, through an abuse or acquisition and abuse of a dominant position of market power, they limit access to markets or otherwise unduly restrain competition, having or being likely to have adverse effects on international trade, particularly that of developing countries, and on the economic development of these

countries. For example, part IV, section D, 4, e, calls upon enterprises to refrain from imposing restrictions on the importation of goods which have been legitimately marked abroad with a trade mark identical or similar to the trade mark protected as to similar goods in the importing country where the trade marks are of the same origin, i.e. belong to the same owner or used by enterprises between which there is economic, organizational or legal interdependence and where the purpose of such restrictions is to maintain artificially high prices. Part IV, section D, 4, f (iii), calls upon enterprises not to impose restrictions concerning where, or to whom, or in what form or quantities, goods supplied or other goods may be resold or exported by enterprises. At its twenty-eighth session in March 1984, the Intergovernmental Group on Restrictive Business Practices agreed to recommend that a United Nations Conference on Restrictive Business Practices be convened in 1985 to review all aspects of the Set of Principles and Rules.

III. UNCTAD draft Model Law on restrictive business practices

39. The UNCTAD draft Model Law on restrictive business practices was prepared by the UNCTAD secretariat and was first considered by the Third *Ad Hoc* Group of Experts on Restrictive Business Practices.¹⁶ A revised draft¹⁷ was examined by the Intergovernmental Group of Experts on Restrictive Business Practices in November 1983, and another revised draft¹⁸ was considered by the same Group in November 1984.¹⁹ Some of the elements of this draft are set forth below.

Objectives or purpose of the Law

40. The objectives or purpose of the Model Law are to eliminate or effectively deal with acts or behaviour of enterprises which, through an abuse or acquisition and abuse of a dominant position of market power, limit access to markets or otherwise unduly restrain competition in such a way as to have or be likely to have adverse effects on trade or economic development.

Scope of application

41. The draft Model Law applies to all enterprises as defined by it and to such transactions in goods and services, and restrictive business practices falling within its scope. It does not apply to agreements entered into by a State, or to practices directly caused by such agreements.

Restrictive agreements or arrangements

42. The Law should include a prohibition (except when enterprises deal with each other in the context of an economic entity wherein they are under common

¹⁵E/C.10/1982/6, para. 36; see, also, E/C.10/1984/5, para. 63.

¹⁶TD/250.

¹⁷TD/B/RBP/15.

¹⁸TD/B/RBP/15/Rev.1.

¹⁹See TD/B/RBP/L.16/Add.4.

control) on the enterprises engaging in practices of the type listed below when:

Enterprises are engaged in the market in rival or potentially rival activities;

The practices arise through formal, informal, written or unwritten agreements or arrangements;

The practices limit access to markets or otherwise unduly restrain competition, having or being likely to have adverse effects on trade or economic development.

Acts or behaviour in an abuse or acquisition and abuse of a dominant position of market power

43. The Law should include a prohibition on acts or behaviour in an abuse, or acquisition and abuse, of a dominant position of market power:

When the acts or behaviour take place in a relevant market;

Where an enterprise, either by itself or acting together with a few other enterprises, is in a position to control the relevant market for a particular good or service, or groups of goods or services;

When the acts or behaviour limit access to markets or otherwise unduly restrain competition having or being likely to have adverse effects on trade or economic development.

Some possible aspects of consumer protection

44. The Law should include a prohibition on enterprises engaging in practices such as the following:

When engaged in the manufacture or importation of products, failing to ensure an adequate supply of spare parts and replacements, or failing to maintain an adequate after-sales service for consumers, except for reasons outside their control;

Declining liability for defective products or services rendered not meeting the supplier's description of such goods and services;

In connection with the supply of products or services, making any warranty: (i) limited to a particular geographic area or sales point; (ii) falsely representing that products are of a particular style or model; (iii) falsely representing that the goods are new or of a specified age; (iv) representing that products or services have any sponsorship, approval, performance and quality characteristics, components, materials, accessories, uses or benefits which they do not have.

Functions and powers of the administering authority

45. The Model Law makes provision for an Administering Authority to be created. The functions and powers of the Authority may include the following:

To make inquiries and investigations, including inquiries and investigations as a result of receipt of complaints;

To make the necessary decisions, including the imposition of sanctions;

To issue forms and maintain a register for notifications;

To make regulations;

To assist in the preparation of new legislation or the amending of existing legislation on restrictive business practices.

IV. WIPO: Revision of the Paris Convention and technology transfer

46. Developing countries have made two proposals to revise the Paris Convention for the protection of industrial property, 1883,²⁰ which may affect the transfer of technology to developing countries. The first proposal deals with the right of any developing country to provide for the automatic forfeiture or revocation of a patent where a patented invention is not worked or is insufficiently worked after a certain period from the grant of the patent. The second proposal gives the right to a country where an invention has been patented to grant temporary exclusive compulsory licences where a patented invention has not been worked or has been insufficiently worked. Thus, a particular Government could grant an exclusive compulsory licence independently of the patent owner. Such an exclusive compulsory licence would prevent the patent owner from working the invention in the country in which the licence is granted. Furthermore, once an exclusive compulsory licence is granted, the owner of the patent cannot import into the country where the patent is being worked by the licensee, products resulting from the working of the patent elsewhere.

47. The concerns which led to the proposals are that patent holders sometimes use their patents to monopolize the importation of products into developing countries, and to maintain at a high level the price of such products. Under the proposals, the Government of a developing country could not only threaten an owner with forfeiture of his patent, but could further grant an exclusive licence under the owner's patent and thereby exclude the patent owner from the market. However, a possible result of the implementation of the proposal may be that a developed country may not apply for a patent in a country which applies such provisions and there would therefore be no chance of working the patent in that country. No agreement was reached at the fourth session (1984) of the diplomatic Conference on the Revision of the Paris Convention for the Protection of Industrial Property.

V. WIPO model provisions on the protection of computer software

48. The Model Provisions on the protection of computer software (hereinafter referred to as the draft Model)²¹ are intended to provide an appropriate form of legal protection for computer programs with a view

²⁰United Nations, *Treaty Series*, vol. 828, pp. 305-388, 1967. The current revision is being undertaken by WIPO.

²¹WIPO, Publication No. 814(E) (Geneva, 1978).

to facilitating the access of developing countries to information on computer software. "Computer software" is defined in section 1 of the draft Model and means any or several of the following items: a computer program, a program description or supporting material. These items are defined as follows:

"Computer program" means a set of instructions capable, when incorporated in a machine-readable medium, of causing a machine having information-processing capabilities to indicate, perform or achieve a particular function, task or result;

"Program description" means a complete procedural presentation in verbal, schematic or other form, in sufficient detail to determine a set of instructions constituting a corresponding computer program;

"Supporting material" means any material, other than a computer program or a program description, created for aiding the understanding or application of a computer program, for example problem descriptions and user instructions.

49. Section 5 of the draft Model provides for the type of protection needed for computer software. The owner of rights in computer software could, for example, prevent any person from disclosing the computer software or facilitating its disclosure to any person before it is made accessible to the public; allowing or aiding someone to have access to any apparatus storing or reproducing the computer software before the computer software is made public; copying of any forms of computer software; or using the computer program to produce the same or a substantially similar computer program or a program description of the computer program or of a substantially similar computer program. Furthermore, the draft Model permits the owner to prevent the actual use of a computer program to control a machine with information-processing capabilities and to prevent the sale, lease or licensing of computer software or objects storing the software. Other provisions deal with infringements, duration of rights, relief, and application of other laws.

50. A Committee of Experts on the Legal Protection of Computer Software met in June 1983²² to deliberate on the draft Model. The Committee considered it at present premature to take a stand on the question of the best form for the international protection of computer software and recommended that the consideration of the conclusion of a special treaty as presented should not be pursued for the time being.

VI. WIPO Model Law for developing countries on inventions

51. The Model Law for developing countries on inventions (in two volumes)²³ is a revision of an earlier

²²LPCS/11/6.

²³WIPO, *Model Law for Developing Countries on Inventions: Vol. I, Patents*, Publication No. 840(E) (Geneva, 1979) and *Vol. II, Know-how; Examination and Registration of Contracts; Inventors' Certificates; Technological Innovations; Transfer of Technology Patents*, Publication No. 841(F) (Geneva, 1980).

version published in 1965 by its predecessor, the United International Bureaux for the Protection of Intellectual Property (BIRPI). The Model Law is intended to be a model for a national law but could be equally adapted for a regional law for the protection of inventions. According to the preamble of the Model Law, one of the basic conditions for creating new technology or adapting existing technology to the needs of the country and for having access to foreign technology is the establishment of an appropriate legal and administrative framework for the promotion of inventiveness. The protection of inventions and the remuneration of innovations are considered to be important elements of such a framework. Volume I of the Model Law, entitled "Patents", contains model provisions, followed by a commentary, and model regulations on patents. Volume II, entitled "Know-how; examination and registration of contracts; inventors certificates; technological innovations; transfer of technology", deals with those topics mentioned in the title and is structured along the same lines as volume I, i.e. it contains model provisions, followed by a commentary, and model regulations.

VII. Guides, model forms and clauses relating to technology transfer

A. Completed projects

Handbook on the Acquisition of Technology by Developing Countries (United Nations publication, Sales No. E.78.II.D/15) (UNCTAD/TT/AS/5)

52. This UNCTAD Handbook deals with the acquisition of technology by developing countries and, according to its preface, it is complementary to the WIPO Licensing Guide for developing countries (see para. 56, below). The Handbook includes topics on development and technology, range of options in acquiring technology, international technology transactions, objectives in negotiations, acquiring technology through foreign investment, acquiring technology through public sector enterprises, the costs of acquiring technology, the development of domestic technological capabilities, institutional arrangements and national legislative framework.

Guidelines for Evaluation of Transfer of Technology Agreements, (ID/233), Development and Transfer of Technology Series, No. 12 (New York, United Nations, 1979)

53. The United Nations Industrial Development Organization (UNIDO) Guidelines are intended to provide the business community and governments in developing countries with a comprehensive text as an aid in dealing with technology transfer transactions. They provide practical information on the preparation and negotiation of various technology transfer agreements. This volume is an extension of an earlier publication on the acquisition of foreign technology in developing countries (see para. 55, below).

54. These Guidelines examine several types of technology transfer agreements relating to technical

assistance, patents, know-how, engineering services, trade marks and franchises. Suggestions are made as to how the acquirer of technology might derive the maximum benefit from such agreements. Suggestions are also made as to how national agencies regulating technology transfer agreements might regulate such agreements so as to benefit the national economy. Considerable attention is paid to the subject of process performance guarantees, and methods of evaluation of these agreements are outlined. Also included are the techniques for evaluating the price of technology and information on the legal and administrative provisions in technology agreements.

Guidelines for the Acquisition of Foreign Technology in Developing Countries: with Special Reference to Technology Agreements (United Nations publication, Sales No. E.73.II.B.1) (ID/98)

55. These UNIDO Guidelines deal with transfer of technology to developing countries through the licensing mechanism. They deal with general trends in the transfer of technology to developing countries and the principal objectives of the transfer. They also discuss the various channels for acquiring foreign technology and the problems facing developing countries in selecting a particular technology as well as selecting the licensor or other supplier of technology. A check-list for licensees negotiating technology license agreements is included.

Licensing Guide for Developing Countries: a Guide on the Legal Aspects of the Negotiation and Preparation of Industrial Property Licences and Technology Transfer Agreements Appropriate to the Needs of Developing Countries, Publication No. 620 (E) (Geneva, WIPO, 1979)

56. The purpose of this WIPO Guide is to give practical help with the legal aspects of the negotiation and the preparation of industrial property licences and technology transfer agreements appropriate to the needs of developing countries. It identifies the legal questions which arise in such licences and agreements, draws attention to features which may be detrimental to licensees or technology recipients and suggests possible solutions. It contains illustrative clauses which may assist in the drafting of licensing agreements.

57. Among the topics included in the Guide are the scope of the licence, some aspects concerning patents, know-how, technical services and assistance, compensation, consideration, price, remuneration, royalties and fees, settlement of payment, most favourable terms and conditions, and settlement of disputes. The guide is currently being revised.

Guide for Use in Drawing up Contracts relating to the International Transfer of Know-how in the Engineering Industry (United Nations publication, Sales No. E.70.II.E.15) (TRADE/222/Rev.1)

58. This Economic Commission for Europe (ECE) Guide is intended to facilitate the drawing up of contracts relating to the international transfer of know-

how in the engineering industry. It draws attention to certain problems pertaining to this type of contract.

Manual on the Use of Consultants in Developing Countries (United Nations publication, Sales No. E.72.II.B.10) (ID/3, Rev.1)

59. The primary aim of this UNIDO Manual is to provide background information on the selection and effective use of consulting services and also the types of contract forms commonly used. Among the topics covered are contracting procedures, consulting fees, the client-consultant relationship, the local consulting profession in developing countries, technological services, management services and training programmes.

Guide for Drawing up International Contracts on Consulting Engineering Including Some Related Aspects of Technical Assistance (United Nations publication, Sales No. E.83.II.E.3) (ECE/TRADE/145)

60. This ECE Guide deals with consulting engineering and some aspects of technical assistance related to consulting engineering. The purpose of the Guide is to assist in the drawing up of international contracts in this field by drawing attention to the main clauses found in such contracts.

Manual on the Establishment of Industrial Joint-Venture Agreements in Developing Countries (United Nations publication, Sales No. E.71.II.B.23) (ID/68)

61. This UNIDO Manual deals with a number of major issues confronting the host country partners in the negotiation and execution of joint-venture agreements. Among the topics covered are patent licensing arrangements and technical information, technical assistance and know-how.

"UNIDO model form of turnkey lump sum contract for the construction of a fertilizer plant including guidelines and technical annexures" (UNIDO/PC.25/Rev.1)

"UNIDO model form of cost-reimbursable contract for the construction of a fertilizer plant including guidelines and technical annexures" (UNIDO/PC.26/Rev.1)

62. The UNIDO model on turnkey lump-sum contracts and the UNIDO model on cost-reimbursable contracts cover the rights and obligations of the parties in a turnkey contract and a cost-reimbursable contract, respectively, for a fertilizer plant. They are tailored to the special requirements and problems of developing countries and contain model provisions for most of the clauses commonly found in such contracts.

B. On-going projects

1. UNIDO System of Consultations

63. The UNIDO System of Consultations is designed to assist developing countries in accelerating their industrialization and in achieving a more equitable share of industrial activity. Pursuant to the objective of the System of Consultations, the UNIDO secretariat is

preparing some model forms of contracts and "items" to be included in contractual arrangements in certain industrial sectors. Below is a list of various models and "items" that are intended to assist the recipient of technology in developing countries to draft and negotiate transfer-of-technology arrangements in various industrial sectors which would ensure a balance of interests between the parties.

(a) *Fertilizer industry*

64. The First Consultation on the Fertilizer Industry, held in 1977, recommended that UNIDO examine contracts which would ensure the successful construction and operation of fertilizer plants (see, e.g. the turnkey contract, para. 62, above). Pursuant to this recommendation, the following models are being prepared:

"Second draft of the UNIDO model form of semi-turnkey contract for the construction of a fertilizer plant, including guidelines and technical annexures" (UNIDO/PC.74).

"Second draft of the UNIDO model form of licensing and engineering services agreement for the construction of a fertilizer plant including guidelines and technical annexures" (UNIDO/PC.73).

(b) *Petrochemical industry*

65. The First Consultation on the Petrochemical Industry, held in 1979 recommended that UNIDO prepare a model form of agreement for the licensing of patents and know-how in the petrochemical industry, and a set of guidelines on its use. Pursuant to this recommendation, the UNIDO secretariat is preparing a model form, the latest version of which is entitled "UNIDO model form of agreement for the licensing of patents and know-how in the petrochemical industry, including annexures, an integrated commentary and alternative texts of some clauses" (UNIDO/PC.50/Rev.1).

(c) *Agricultural machinery industry*

66. One of the recommendations of the First Consultation on the Agricultural Machinery Industry, held in 1979, was to prepare model contracts dealing with licensing for local manufacture and joint ventures, taking into account, wherever appropriate, the model contracts under preparation within the framework of the UNIDO System of Consultations. Pursuant to this recommendation, the UNIDO secretariat has prepared a draft document entitled "Items to be included in model contracts for the import, assembly and manufacture of agricultural equipment including training; model licensing agreement" (ID/WG.400/2).

(d) *Pharmaceutical industry*

67. In accordance with recommendation No. 2 of the First Consultation on the Pharmaceutical Industry, held in 1980, the UNIDO secretariat has prepared the following documents:

"Items which could be incorporated in contractual arrangements for the transfer of technology for the

manufacture of those bulk drugs/intermediates included in UNIDO's illustrative list" (ID/WG.393/1).

"Items which could be included in licensing arrangements for the transfer of technology for the formulation of pharmaceutical dosage forms" (ID/WG.393/3).

"Items which could be included in contractual arrangements for the setting up of a plant for the production of bulk drugs (or intermediates) included in UNIDO illustrative list" (ID/WG.393/4).

2. *UNIDO/International Centre for Public Enterprises in Developing Countries joint project*

68. In 1980 the secretariat of UNIDO and the International Centre for Public Enterprises in Developing Countries (ICPE) embarked on a joint project for the preparation of a guide dealing with warranty and guaranty issues in technology transfer transactions. Pursuant to this decision a draft document entitled "Guide on guaranty and warranty provisions in technology transfer transactions, particularly for developing countries" has been prepared. It deals with the meaning and scope of guaranty/warranty provisions in modern, complex technology agreements, approaches to drafting such provisions and measures to be taken if the guaranty or warranty is not met. Furthermore, the draft Guide provides illustrations of guarantee provisions.

VIII. *Advisory and information services*

A. *Advisory Service on Transfer of Technology (UNCTAD)*

69. The Advisory Service on Transfer of Technology provides the necessary institutional basis for co-operating with developing countries and assisting them in matters pertaining to the transfer and development of technology. It provides advice on, *inter alia*, the formulation of laws and regulations aiming at the technological transformation of developing countries.

B. *Advisory and Information Services Division (UNCTC)*

70. The Advisory and Information Services Division provides advisory services and information to requesting Governments on matters such as foreign investment policies, laws and regulations, the evaluation and screening of investment and technology acquisition proposals, contractual arrangements and other matters related to transnational corporations.

C. *Technological Advisory Services (UNIDO)*

71. The Technological Advisory Services provides a specialized advisory service to Governments of developing countries in contracting for industrial projects, particularly in the preparation for negotiation of

contracts in the field of joint ventures, turnkey deliveries, licences, know-how, management and franchising services, including financial arrangements. It also assists in the drafting of these agreements.

D. *Technological Information Exchange System (UNIDO)*

72. The Technological Information Exchange System provides data on terms and conditions of licensing, know-how and technical assistance agreements entered into by developing countries participating in the System. Through this System, the central bodies regulating the transfer of technology in participating countries obtain valuable information, both on terms and conditions of the import of technology, and also comparable data as to their own performance.

IX. SELECTED PUBLICATIONS

73. In addition to the guides, model forms and clauses referred to in section VII, above, the following publications deal with some general legal aspects relating to technology transfer:

UNCTAD

"The role of the patent system in the transfer of technology to developing countries" (TD/B/AC.11/19/Rev.1)

"Review of major developments in the area of restrictive business practices" (TD/B/C.2/159)

"Information for the effective control of restrictive business practices affecting the trade and development of developing countries and the role of UNCTAD in the collection and dissemination of information" (TD/B/C.2/AC.6/6 and Corr.1)

"Recent developments in the control of restrictive business practices in Latin America" (TD/B/C.2/AC.6/17)

"The role of trade marks in developing countries (in co-ordination with WIPO)" (TD/B/C.6/AC.3/3/Rev.1)

"Restrictive business practices affecting international trade, particularly that of developing countries, and the economic development of these countries" (TD/RBP/CONF.2).

"Legislation and regulations on technology transfer: empirical analysis of their effects in selected countries; the implementation of transfer of technology regulations: a preliminary analysis of the experience of Latin America, India and Philippines" (TD/B/C.6/55)

"Annual report 1982 on legislative and other developments in developed and developing countries in the control of restrictive business practices" (TD/B/RBP/11).

"Control of restrictive practices in transfer of technology transactions: selected principal regulations,

policy guidelines and case law at the national and regional levels" (TD/B/C.6/72)

"Organizational forms of transfer of technology to developing countries by small and medium-sized enterprises: a case study of equity joint ventures and technology agreements in Latin America" (TD/B/C.6/77)

"Compilation of legal material dealing with transfer and development of technology" (TD/B/C.6/81)

"Restructuring the legal environment: international transfer of technology: common approaches to laws and regulations on the transfer and acquisition of technology" (TD/B/C.6/91)

"Tied purchasing" (TD/B/RBP/18)

"Restrictive business practices in the services sector by consulting firms and other enterprises in relation to the design and manufacture of plant and equipment" (TD/B/RBP/19)

United Nations

Guidelines for Contracting for Industrial Projects in Developing Countries (ID/149) (United Nations publication, Sales No. E.75.II.B.3)

UNIDO

National Approaches to the Acquisition of Technology, Development and Transfer of Technology Series, No. 1 (ID/187) (New York, United Nations, 1977)

"Relevant issues to be taken into account when negotiating transfer of technology agreements" (ID/WG.331/2)

"Background paper for discussion on the relevant issues to be taken into account when negotiating transfer of technology agreements and the various terms, conditions and variations thereof that could be included in contractual agreements; possible scope, structure and content" (UNIDO/PC.19)

"Review of systems for regulating technology inflows in selected developing countries" (UNIDO/IS.253)

"Licensing computer software: basic considerations as to protection and licensing of computer software and its implication for developing countries" (ID/WG.383/3)

"Guidelines for the establishment of industrial joint-ventures in developing countries" (UNIDO/IS.361)

"Restrictive clauses in licensing agreements in the pharmaceutical industry" (ID/WG.405/5)

74. The following reports on licensing and transfer of technology agreements were submitted to the Regional Workshop on Technology Acquisition through Licensing Agreements by Exchange of Experience between Selected Developing Countries in Asia and the Far East, under the auspices of UNIDO, in 1975:

"Essential preparations for international licensing: a review of selected aspects of licence negotiation" (ID/WG.206/1)

"Review of legislative and administrative systems for the regulation of technology transfer agreements" (ID/WG.206/2)

"Restrictive business practices in licensing agreements" (ID/WG.206/3)

"Selection of technology and its adaptation: Japanese experience" (ID/WG.206/4)

"Licensing, turn-key and joint venture contracts" (ID/WG.206/5)

"Acquiring technology for metallurgical industries" (ID/WG.206/6)

"Contractual arrangements and policy aspects in technology licensing" (ID/WG.206/7)

"Preparation of licence agreements and negotiating strategy" (ID/WG.206/8)

75. The following reports were submitted to the High-Level Policy Meeting of ASEAN on the Regulation of Technology Transfer, under the auspices of UNIDO, in 1981:

"Technology transfer—Malaysia's experience" (ID/WG.349/2)

"Philippine experience in technology transfer regulation" (ID/WG.349/3)

76. The following reports were submitted to a UNIDO/LES Joint Meeting on Problems on Licensing in Developing Countries, under the auspices of UNIDO, in 1982:

"Overview of selected problems of technology transfer to developing countries" (ID/WG.388/1)

"Technology transfer by Portugal: an overview" (ID/WG.388/2)

"Acquisition of foreign technology in Egypt: a new approach" (ID/WG.388/3)

"Observations regarding the transfer of technology in Spain" (ID/WG.388/4)

"Policy, procedures and problems regarding import of technology by India" (ID/WG.388/5)

Measures Strengthening the Negotiating Capacity of Governments in their Relations with Transnational Corporations: Technology Transfer through Transnational Corporations (ST/CTC/47) (United Nations publication, Sales No. 83.II.A.19)

United Nations Commission for Transnational Corporations

"National legislation and regulations relating to transnational corporations" (ST/CTC/26)

Transnational Corporations in World Development: Third Survey (ST/CTC/46) (United Nations publication, Sales No. E.83.II.A.14)

Management Contracts in Developing Countries: an Analysis of their Substantive Provisions (ST/CTC/27) (United Nations publication, Sales No. E.82.II.A.21)

United Nations Institute for Training and Research (UNITAR)

The international transfer of commercial technology of developing countries, Unitar Research Report, No. 13, UNITAR, 1979, United Nations, New York

Economic Commission for Europe (ECE)

The guide on drawing up international contracts for industrial co-operation, ECE/TRADE/124; E.76.II.E.14, 1976, United Nations, New York

The manual on licensing procedures in member countries of the United Nations Economic Commission for Europe, Clark Boardman Co. Ltd., 1980, New York

Economic and Social Commission for Asia and the Pacific (ESCAP)

ESCAP guidelines for development of industrial technology in Asia and the Pacific, E/CN.11/1273, 1976, United Nations, Bangkok

WIPO-LAWASIA

WIPO-LAWASIA seminar on industrial property (WIPO Publication No. 647(E)); WIPO, Geneva

VII. STATUS OF CONVENTIONS

Status of conventions: note by the secretariat (A/CN.9/271)^a

1. At its thirteenth session, the Commission decided that it would consider, at each of its sessions, the status of conventions that were the outcome of work carried out by it. (Report of the United Nations Commission on International Trade Law on the work of its thirteenth session, *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17* (A/35/17), para. 163.)

^aFor consideration by the Commission see *Report*, chapter VIII (part one, A, above).

2. The present note is submitted pursuant to that decision. The annex hereto sets forth the state of signatures, ratifications and accessions as at 1 May 1985 to the following conventions: Convention on the Limitation Period in the International Sale of Goods (New York, 1974); Protocol amending the Convention on the Limitation Period in the International Sale of Goods (Vienna, 1980); United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg); and United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980).

ANNEX

1. *Convention on the Limitation Period in the International Sale of Goods* (New York, 1974)

<i>State</i>	<i>Signature</i>	<i>Ratification</i>	<i>Accession</i>
Argentina			9 October 1981
Brazil	14 June 1974		
Bulgaria	24 February 1975		
Byelorussian SSR	14 June 1974		
Costa Rica	30 August 1974		
Czechoslovakia	29 August 1975	26 May 1977	
Dominican Republic			23 December 1977
Egypt			6 December 1982*
German Democratic Republic	14 June 1974		
Ghana	5 December 1974	7 October 1975	
Hungary	14 June 1974	16 June 1983	
Mongolia	14 June 1974		
Nicaragua	13 May 1975		
Norway	11 December 1975	20 March 1980	
Poland	14 June 1974		
Ukrainian SSR	14 June 1974		
USSR	14 June 1974		
Yugoslavia			27 November 1978

Signatures only: 10; ratifications: 4; accessions: 4

Declarations and reservations

Upon signature, Norway declared that in accordance with article 34 the Convention would not govern contracts of sale where the seller and the buyer both had their relevant places of business within the territories of the Nordic States (i.e. Norway, Denmark, Finland, Iceland and Sweden).

*By virtue of accession to Protocol Amending the Convention on the Limitation Period in the International Sale of Goods (Vienna, 1980) (art. VIII (2) of the Protocol).

2. *Protocol amending the Convention on the Limitation Period in the International Sale of Goods (Vienna, 1980)*

<i>State</i>	<i>Accession</i>
Egypt	6 December 1982
Hungary	16 June 1983
Argentina	19 July 1983

3. *United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg)*

<i>State</i>	<i>Signature</i>	<i>Ratification</i>	<i>Accession</i>
Austria	30 April 1979		
Barbados			2 February 1981
Brazil	31 March 1978		
Chile	31 March 1978	9 July 1982	
Czechoslovakia	6 March 1979		
Denmark	18 April 1979		
Ecuador	31 March 1978		
Egypt	31 March 1978	23 April 1979	
Finland	18 April 1979		
France	18 April 1979		
Germany, Federal Rep. of	31 March 1978		
Ghana	31 March 1978		
Holy See	31 March 1978		
Hungary	23 April 1979	5 July 1984	
Lebanon			4 April 1983
Madagascar	31 March 1978		
Mexico	31 March 1978		
Morocco			12 June 1981
Norway	18 April 1979		
Pakistan	8 March 1979		
Panama	31 March 1978		
Philippines	14 June 1978		
Portugal	31 March 1978		
Romania			7 January 1982
Senegal	31 March 1978		
Sierra Leone	15 August 1978		
Singapore	31 March 1978		
Sweden	18 April 1979		
Tunisia			15 Sept. 1980
Uganda			6 July 1979
United Rep. of Tanzania			24 July 1979
United States of America	30 April 1979		
Venezuela	31 March 1978		
Zaire	19 April 1979		

Signatures only: 24; ratifications: 3; accessions: 7

Declarations and reservations

Upon signing the Convention, the Czechoslovak Socialist Republic declared in accordance with article 26 a formula for converting the amounts of liability referred to in paragraph 2 of that article into the Czechoslovak currency and the amount of the limits of liability to be applied in the territory of the Czechoslovak Socialist Republic as expressed in the Czechoslovak currency.

4. *United Nations Convention on Contracts for the International Sale of Goods, Vienna (1980)*

<i>State</i>	<i>Signature</i>	<i>Ratification</i>	<i>Accession</i>
Argentina			19 July 1983
Austria	11 April 1980		
Chile	11 April 1980		
China	30 September 1981		
Czechoslovakia	1 September 1981		
Denmark	26 May 1981		
Egypt			6 December 1982

<i>State</i>	<i>Signature</i>	<i>Ratification</i>	<i>Accession</i>
Finland	26 May 1981		
France	27 August 1981	6 August 1982	
German Democratic Republic	13 August 1981		
Germany, Federal Rep. of	26 May 1981		
Ghana	11 April 1980		
Hungary	11 April 1980	16 June 1983	
Italy	30 Sept. 1981		
Lesotho	18 June 1981	18 June 1981	
Netherlands	29 May 1981		
Norway	26 May 1981		
Poland	28 September 1981		
Singapore	11 April 1980		
Sweden	26 May 1981		
Syrian Arab Republic			19 October 1982
United States of America	31 August 1981		
Venezuela	28 September 1981		
Yugoslavia	11 April 1980	27 March 1985	

Signatures only: 17; ratifications: 4; accessions: 3

Declarations and reservations

Upon signing the Convention, the Governments of Denmark, Finland, Norway and Sweden declared in accordance with article 92 (1) that they would not be bound by part II of the Convention (Formation of the Contract).

Upon ratifying the Convention, the Government of Hungary declared that it considered the General Conditions of Delivery of Goods between Organizations of the Member Countries of the Council for Mutual Economic Assistance to be subject to the provisions of article 90 of the Convention.

Upon ratifying the Convention, the Governments of Argentina and Hungary stated, in accordance with articles 12 and 96 of the Convention, that any provision of article 11, article 29 or part II of the Convention that allows a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form other than in writing, does not apply where any party has his place of business in their respective States.

VIII. TRAINING AND ASSISTANCE

Training and assistance: report of the Secretary-General (A/CN.9/270)^a

1. At the seventeenth session of the Commission,¹ there was wide agreement that the sponsorship of regional symposia and seminars on international trade law in general should be continued and strengthened. It was stressed that such symposia and seminars were of great benefit to lawyers and businessmen in developing countries. The Commission approved the general approach taken by the secretariat in the organization of symposia and seminars.

2. By its resolution 39/82 of 13 December 1984 on the report of the Commission on the work of its seventeenth session, the General Assembly reaffirmed the importance, in particular for developing countries, of the work of the Commission concerned with training and assistance in the field of international trade law. It also reaffirmed the desirability for the Commission to sponsor symposia and seminars, in particular those organized on a regional basis, to promote training and assistance in the field of international trade law. The General Assembly also expressed its appreciation to Governments and institutions for arranging symposia and seminars, and invited Governments, relevant United Nations organs, organizations, institutions and individuals to assist the secretariat in financing and organizing symposia and seminars. The main activities undertaken in this field since the date of the report on training and assistance presented to the seventeenth session of the Commission (A/CN.9/256), and some activities which are intended to be undertaken in the course of 1985 and early 1986, are set forth below in the chronological order in which they have occurred or are expected to occur.

3. The UNCITRAL secretariat collaborated in a joint working programme (Vienna, 5 September 1984) with the International Bar Association (IBA). The agenda related to topics of special interest to Committee D (concerned with procedures for settling disputes) and Committee T (concerned with international construction contracts) of the IBA, and there was a discussion of the progress of work on the UNCITRAL draft Model Law on international commercial arbitration (hereinafter referred to as the UNCITRAL draft Model Law) and the UNCITRAL draft Legal Guide on

drawing up international contracts for the construction of industrial works (hereinafter referred to as the UNCITRAL draft Legal Guide on industrial contracts).

4. An Asian Pacific Regional Trade Law Seminar (Canberra, Australia, 22-27 November 1984) was conducted by the Attorney-General's Department of Australia, in association with the UNCITRAL secretariat and the Asian-African Legal Consultative Committee. The International Institute for the Unification of Private Law (UNIDROIT) and the Hague Conference on Private International Law also participated. The seminar was attended by lawyers, businessmen and government officials from twenty-five countries in the region. Fellowships were provided by the Government of Australia for participants from the region. The main subjects emanating from the work of the Commission which were discussed were the United Nations Convention on the Carriage of Goods by Sea, 1978 (hereinafter referred to as the Hamburg Rules), the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (hereinafter referred to as the Vienna Sales Convention), and the UNCITRAL draft Legal Guide on industrial contracts. Other subjects discussed included the Convention on Agency in the International Sale of Goods, Geneva, 1983, the revision of the Convention on the Law Applicable to the International Sale of Goods, The Hague, 1955, and the settlement of international commercial disputes in the region.

5. The UNCITRAL secretariat participated in a seminar (Dubrovnik, Yugoslavia, 11-23 March 1985) on the international sale of goods organized by the Inter-University Centre of Postgraduate Studies, Dubrovnik. The major topic for discussion was the Vienna Sales Convention. The seminar was intended as an intensive course for young lawyers and legal researchers at the post-graduate level and was attended by forty participants, mostly from various European countries. Fellowships for attending the seminar were provided by the Deutscher Akademischer Austauschdienst of the Federal Republic of Germany, the Inter-University Centre, the Swiss National Fund, and Zagreb University.

6. The Chamber of Commerce of Bogotá and the UNCITRAL secretariat will organize a regional seminar (Bogotá, Colombia, 22-23 April 1985) on international trade law and foreign trade, with the support of the secretariat of the Organization of American States. The seminar will be attended by practising

^aFor consideration by the Commission see Report, chapter VII (part one, A, above).

¹Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 141.

lawyers, law teachers and businessmen from countries of the Andean region. The subjects to be discussed are UNCITRAL's role in Latin America, the Hamburg Rules, the Convention on the Limitation Period in the International Sale of Goods, New York, 1974, the Vienna Sales Convention, the UNCITRAL Arbitration Rules and Conciliation Rules, the UNCITRAL draft Model Law and the UNCITRAL draft Legal Guide on industrial contracts.

7. The UNCITRAL secretariat will collaborate, together with the Economic University of Vienna, in a summer school seminar (Vienna, 7 July-2 August 1985) organized by the Dickinson School of Law, Pennsylvania, United States, dealing with the unification and harmonization of international trade law. The seminar will deal in general with the work of UNCITRAL and will consider in detail the Vienna Sales Convention, the UNCITRAL draft Model Law, and the UNCITRAL draft Legal Guide on industrial contracts.

8. The UNCITRAL secretariat will participate in a Euro-Arab Congress (Port El-Kantaouy (Sousse), Tunisia, 24-27 September 1985) on arbitration in Euro-Arab relations. The Congress will be a biregional symposium organized by the Euro-Arab Chambers of Commerce.

9. The UNCITRAL secretariat will collaborate with the International Development Law Institute in a seminar (Rome, 1-14 December 1985) on resolving international commercial disputes. The seminar will be attended by government officials from developing countries. Among the subjects for discussion will be the UNCITRAL Arbitration Rules and Conciliation Rules and the UNCITRAL draft Model Law.

10. The Government of Djibouti and the International Chamber of Commerce will organize a regional seminar in Djibouti during the course of 1985 on the settlement

of international commercial disputes in developing countries, in collaboration with the Chamber of Industry of Djibouti, the UNCITRAL secretariat, and the European Development Fund. The conference will consider the UNCITRAL Arbitration Rules and Conciliation Rules and the UNCITRAL draft Model Law.

11. The Regional Centre for Commercial Arbitration, Cairo, and the UNCITRAL secretariat are considering the organization of a regional seminar on international commercial arbitration in Cairo early in 1986. The subjects to be discussed are likely to be the promotion of arbitration in the region and the work of UNCITRAL in the field of the settlement of international commercial disputes through arbitration and conciliation. It is expected that participants from several Middle Eastern countries will attend.

12. The UNCITRAL secretariat will have discussions with the United Nations Institute for Training and Research (UNITAR) and the United Nations Development Programme (UNDP) with a view to collaborating with those institutions in including international trade law subjects in the regional symposia and seminars organized by them in developing countries.

13. On several occasions other than those mentioned in the preceding paragraphs, the UNCITRAL secretariat has addressed gatherings of lawyers and government officials in order to promote the work of the Commission. The secretariat has also contributed articles to legal periodicals on various aspects of the Commission's work. The secretariat intends to keep in touch with organizations and Governments with a view to collaborating with them in organizing symposia and seminars.

14. Since the seventeenth session of the Commission, three interns received training with the UNCITRAL secretariat and were associated with on-going projects of the Commission.

IX. DISSEMINATION OF DECISIONS

Dissemination of decisions concerning UNCITRAL legal texts and uniform interpretation of such texts: note by the secretariat (A/CN.9/267)*

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Introduction

1. At the sixteenth (1983) and seventeenth (1984) sessions of the United Nations Commission on International Trade Law, suggestions were made that means should be explored to disseminate judicial and arbitral decisions concerning legal texts emanating from the work of the Commission.¹ At the session of the Sixth Committee held during the thirty-ninth session of the General Assembly, a request was also made that the secretariat submit a paper on this subject to the eighteenth session of the Commission.² Although, as more fully discussed below, it might be premature at this time for the Commission to formulate concrete mechanisms to disseminate decisions relating to UNCITRAL legal texts, this paper is presented in response to the suggestions and request noted above in order to enable the Commission to begin to consider some of the issues involved in this connection, preliminary to its deciding on concrete measures at the appropriate time. This paper also considers possible means for the Commission to promote the uniform interpretation of legal texts emanating from its work.

2. There does not now exist a well-established mechanism for ensuring that parties to commercial transactions, lawyers, arbitral tribunals or courts have access to decisions of foreign courts or of arbitral tribunals relating to UNCITRAL legal texts. In most parts of the world, decisions of foreign courts are available, if at all, only to a limited extent; collections of reported decisions by courts of large or even representative numbers of countries are available only in the few major law libraries of the world. Even when collections of decisions from a number of countries are available, the lack of an indexing or other system to refer to decisions within each collection concerning UNCITRAL legal texts makes it extremely difficult to identify and become aware of such decisions. Moreover, the comprehensiveness of collections of reported court decisions varies from country to country. In many countries, a degree of selectivity is employed in choosing cases to be reported; in some countries, only a small number of cases are reported. Court decisions may also be available in other sources, such as legal journals. However, these journals often employ an even greater degree of selectivity with respect to the cases which they cover. Moreover, these sources often contain only summaries of, commentaries upon or references to the court decisions, rather than the decisions in full.³ When foreign cases are available, they are usually available only in their original

*For consideration by the Commission see *Report*, chapter IX, D (part one, A, above).

¹Report of the United Nations Commission on International Trade Law on the work of its sixteenth session, *Official Records of the General Assembly, Thirty-eighth Session, Supplement No. 17 (A/38/17)*, para. 137; Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17 (A/39/17)*, para. 155.

²A/C.6/39/SR.4, para. 28.

³Some journals publish complete or edited decisions relating to various international conventions in the field of international trade law, such as the *Uniform Law Review*, published by the International Institute for the Unification of Private Law (UNIDROIT); the *Revue française de droit aérien*, published by the Association d'études et de documentation de droit aérien; *European Transport Law* and *European Commercial Cases*, published by the European Law Centre, Ltd.

languages. The availability of arbitral decisions is even less consistent and comprehensive than that of court decisions.

3. It might be considered whether means should be explored to disseminate decisions relating to all UNCITRAL legal texts, or only certain texts. It may be desirable for such decisions to include those relating to the international conventions emanating from the work of the Commission, model laws adopted by the Commission, and the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules. With respect to decisions concerning the provision for a universal unit of account for expressing monetary amounts in international transport and liability conventions, and the alternative provisions for adjustment of the limits of liability in such conventions, adopted by the Commission in 1982,⁴ it may be difficult for such decisions to be identified and to be selected for dissemination, inasmuch as they will likely appear as or within decisions concerning the international conventions in which such provisions are contained. Moreover, the desirability of disseminating decisions concerning these provisions may be somewhat less compelling, since such decisions are more likely to involve simply the application of straightforward provisions rather than the interpretation of the provisions.

I. Means of collecting and disseminating decisions

4. The Commission might wish to consider possible courses of action for the dissemination of decisions relating to UNCITRAL legal texts. The first step would be to establish a procedure enabling the UNCITRAL secretariat to collect the relevant decisions.

5. With respect to judicial decisions, the most efficient approach might be for each State to provide the secretariat with decisions of courts in that State dealing with UNCITRAL legal texts. The means and forms of reporting judicial decisions vary from country to country, and each State would be in the best position to take the necessary measures to provide the secretariat with decisions of its own courts. At an appropriate time (e.g. after the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) enters into force), the Commission might recommend that the General Assembly adopt a resolution calling upon States to provide the secretariat with such decisions. With respect to arbitral decisions, the resolution could also request institutions which administer international commercial arbitration cases, and arbitral tribunals, to transmit to the secretariat their decisions in cases involving UNCITRAL legal texts, subject to any consent of the parties required under rules governing the arbitration.⁵

⁴Report of the United Nations Commission on International Trade Law on the work of its fifteenth session, *Official Records of the General Assembly, Thirty-seventh Session, Supplement No. 17 (A/CN.3/17)*, para. 63.

⁵Rules of arbitral procedure often provide that decisions in arbitration cases may be made public only with the consent of both parties; see, e.g. UNCITRAL Arbitration Rules, art. 32 (5).

6. The second step would be to devise a means to maximize the worldwide availability of the decisions collected. The following is one possible means by which this might be done. The secretariat would choose decisions to be disseminated. A degree of selectivity might have to be employed in this regard, particularly if court or arbitral decisions were to become numerous. Decisions supplied to the secretariat in one of the six official languages of the United Nations would be issued in some form as documents of the Commission for general distribution (under the A/CN.9/... symbol), in all official languages of the United Nations. In some cases, the complete decisions might be issued; in other cases, it might be necessary for the secretariat to edit or summarize decisions or portions thereof. These documents would be distributed through the usual channels to all governments, as well as to United Nations depository libraries and other recipients worldwide. Each volume of the UNCITRAL Yearbook would contain the decisions which had been issued as UNCITRAL documents over the course of the relevant year. In addition, references could be made to other decisions relating to UNCITRAL legal texts which had been obtained by the secretariat.

7. The dissemination of decisions relating to UNCITRAL legal texts could have financial implications, depending upon the amount of time which the secretariat would have to spend in processing the decisions for issuance as Commission documents, as well as the costs of translating, printing and distributing such documents. If the decisions are not numerous, it might be possible for such costs to be accommodated in the regular budget of the Commission. The Commission may wish to decide upon the concrete procedure for disseminating decisions relating to UNCITRAL legal texts when one or more of the conventions elaborated by the Commission enter into force and the secretariat begins to receive decisions relating to such texts. At that point, it would be possible to assess more accurately the extent of the financial implications involved.

II. Means of promoting uniform interpretation of UNCITRAL legal texts

8. Uniformity in the interpretation of legal texts designed to achieve uniformity of law is a desirable objective. The widespread distribution of decisions concerning UNCITRAL legal texts could itself promote a measure of uniformity in the interpretation of such texts. Such decisions could be taken into consideration by parties in planning and executing their commercial transactions, as well as by lawyers, courts and arbitral tribunals in dealing with disputes arising from such transactions. The extent to which courts will take into account decisions of foreign courts varies, and depends on a number of factors. However, courts are often more apt to take into account foreign decisions relating to legal texts which are intended to achieve international uniformity of law than other decisions. The incentive to take into account foreign decisions could be even greater with respect to decisions relating to the conven-

tions elaborated by the Commission, each of which specifically provides that in the interpretation of the convention, regard is to be had to its international character and to the need to promote uniformity.⁶

9. Consideration might also be given to the question of whether the Commission might play a more direct role in promoting the uniform interpretation of UNCITRAL legal texts. The suitability of various roles is discussed below.

10. *Resolving conflicting interpretations in court or arbitral decisions:* Under this possibility, the Commission would consider conflicts in the interpretation of UNCITRAL legal texts by courts or arbitral tribunals and would express its opinion as to the proper interpretation of the texts. This approach might be found to be unsuitable with respect to conventions elaborated by the Commission and model laws adopted by it. Such legal texts are incorporated into the national laws of the States adhering to the conventions or implementing the model laws. This approach would therefore involve the Commission in intervening in interpretations by courts of their own national laws when the competence to do so has not been granted to the Commission by the States parties to or adopting the texts concerned. In addition, in the case of conventions which have been adopted in final form by forums other than the Commission itself (i.e. by conferences of plenipotentiaries), the Commission would become involved in interpreting texts which it had not even adopted in final form. Moreover, an interpretation of a legal provision is very often made within the particular factual context of the case in which the interpretation is rendered. Therefore, the task of resolving two conflicting interpretations would in many cases require a detailed review of the cases within which the interpretations were rendered. The performance of such a task by the Commission would make it very similar to an "international court of appeal". It might be considered more suitable, however, for the Commission to resolve conflicting interpretations of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, since many of the objections to the performance of such a function with respect to conventions and model laws would not apply to the resolution of conflicting interpretations of these Rules.

11. *Responding to questions referred to the Commission in the context of a dispute:* Under this possibility, the Commission would render interpretations of UNCITRAL legal texts at the request of a court or arbitral tribunal or of one or both of the parties to a

dispute. Many of the factors referred to in the previous paragraph may be relevant to the question of whether such an approach is suitable. It may also be relevant to consider that, if the interpretations were to be rendered by the Commission as a whole at its annual sessions, the resolution of the disputes could be delayed for substantial periods of time until such interpretations were rendered. In addition, it may be considered that in order for such a function to be exercised effectively by the Commission, the parties to the dispute should be entitled to present their views to the Commission on the question referred to it.

12. *Responding to abstract questions of interpretation addressed to the Commission:* Under this possibility, the Commission would respond to abstract questions of interpretation, arising from UNCITRAL legal texts, addressed to the Commission by parties to a commercial transaction or by other interested persons. Such questions are those which do not arise in the context of a dispute (although dealing with such questions may affect concrete disputes). The circumstances discussed in para. 10, above, may also make this approach unsuitable with respect to abstract questions of interpretation of conventions elaborated by the Commission and model laws adopted by it.

13. However, the approach might warrant further consideration with respect to abstract questions of interpretation arising from the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules. Such legal texts have been adopted by the Commission itself and do not constitute part of the national law of States. An analogy might be found in the procedures employed by the Commission on Banking Technique and Practice of the International Chamber of Commerce (ICC), which issues interpretations of the Uniform Customs and Practice for Documentary Credits in response to abstract questions of principle addressed to that Commission by banks and other interested entities or persons. This function is not exercised if the question of interpretation arises in connection with a dispute. The decisions issued by the Commission on Banking Technique and Practice have been published in booklets made available to the general public. If a similar undertaking by the Commission with respect to the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules were thought to merit further exploration, a number of questions would have to be considered, such as whether requests for interpretation should be initially considered by a working group or by another small group of Commission members, the exact terms of reference and procedures to be followed in connection with the exercise of such a function, and the costs of engaging in such a procedure.

14. Certain supra-national institutions have been given competence to render interpretations of conventions and laws designed to achieve uniformity of law. For example, national courts of States members of the European Economic Community may (and, in the case of courts of final recourse, must) call upon the European Court of Justice to interpret the provisions of

⁶See *Official Records of the United Nations Conference on Prescription (Limitation) in the International Sale of Goods* (United Nations publication, Sales No. E.74.V.8), part one, Convention on the Limitation Period in the International Sale of Goods, art. 7: *Official Records of the United Nations Conference on the Carriage of Goods by Sea* (United Nations publication, Sales No. E.80.VIII.1), part I, Final Act of the United Nations Conference on the Carriage of Goods by Sea (A/CONF.89/13), annex I, art. 3; *Official Records of the United Nations Conference on Contracts for the International Sale of Goods* (United Nations publication, Sales No. E.81.IV.3), United Nations Convention on Contracts for the International Sale of Goods (A/CONF.97/1, annex I, art. 7 (1)).

the Treaty of Rome setting up the Community.⁷ In addition, the Benelux countries have established a Benelux Court of Justice which has jurisdiction to render interpretations of uniform laws adopted by those three countries.⁸ Also, the Articles of Agreement of the International Monetary Fund provide that questions of interpretation of the provisions of the Agreement between Fund members or between a member and the Fund shall be submitted to the Executive Directors of the Fund for their decision. A decision issued by the Executive Directors may then be referred to the Board of Governors of the Fund.⁹ However, an essential feature of all of these procedures is that in each case competence is given to the body authorized to interpret the legal text in question by the States which are parties to or which have adopted the text. These procedures may therefore not be viewed as precedents for the assumption by the Commission of competence to interpret legal texts which have been incorporated into the national law of States.

15. In view of the foregoing discussion, the Commission might consider the following to be an appropriate mechanism for dealing with problems concerning the uniform interpretation of UNCITRAL legal texts. In addition to disseminating decisions concerning UNCITRAL legal texts (see para. 6, above), the Commission could request its secretariat also to monitor judicial and arbitral decisions relating to the interpretation of such texts, and to report to the Commission on the status of the interpretation of such texts as circumstances warrant. In pointing out conflicts in the interpretation of provisions of UNCITRAL texts, as well as gaps in such provisions which come to light, the issuance of such reports could itself assist in promoting the uniform interpretation of such texts. Moreover, in the light of these reports, the Commission could consider steps to be taken to deal with such conflicting interpretations or gaps. The nature of such steps would vary with the circumstances, including the nature of the legal texts concerned. For example, with respect to conflicts in the interpretation of provisions of the UNCITRAL Arbitration Rules or the UNCITRAL Conciliation Rules, the Commission might decide to express its opinion as to the correct interpretation of the provisions in question (see para. 10, above). With

respect to these or other UNCITRAL legal texts, the Commission might even as a last resort decide that the text should be amended so as to resolve the conflict in interpretation or the ambiguity. In the case of a text which has been adopted in its final form by the Commission, the Commission could amend the text itself. On the other hand, in the case of a convention elaborated by UNCITRAL, but which has been adopted in final form by a diplomatic conference, the Commission might decide to recommend that procedures be instituted to amend the convention. In some cases, the Commission might consider that a new legal text is needed.¹⁰ The Commission might wish to consider the concrete steps to be taken to deal with problems concerning the uniform interpretation of an UNCITRAL legal text at the time when it considers a report submitted to it by its secretariat pointing out specific problems.

Conclusions

16. At an appropriate time, perhaps after the entry into force of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), the Commission may wish to consider establishing a means of collecting and disseminating court and arbitral decisions relating to international conventions elaborated by the Commission, model laws adopted by the Commission, and the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, as described in paras. 4-6, above. In addition, the Commission may wish to consider following the measures discussed in para. 15, above, to promote the uniform interpretation of these legal texts, as well as the measures discussed in paras. 10 and 13 to promote the uniform interpretation of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules.

¹⁰It may be recalled in this connection that the secretariat submitted to the twelfth session (1979) of the Commission a study on the application and interpretation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (A/CN.9/168). This study noted certain problems with respect to the interpretation and application of the Convention but concluded that despite such problems, the Convention had satisfactorily met the general purpose for which it was adopted, and that an amendment of the Convention was not then necessary. On the other hand, the secretariat recommended that certain other steps be taken to eliminate certain problem areas and to facilitate the application of the Convention (A/CN.9/168, para. 50; see, also, the note by the secretariat on the subject, A/CN.9/169). These steps resulted in the work by the Commission towards the preparation of a model law on international commercial arbitration.

⁷Treaty establishing the European Economic Community (Rome, 1957), art. 177.

⁸Rodière, *Introduction au droit comparé* (1979), p. 132.

⁹Articles of Agreement of the International Monetary Fund, art. XVIII.

I. UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION (A/40/17, ANNEX I)

UNCITRAL model Law on International Commercial Arbitration (as adopted by the United Nations Commission on International Trade Law on 21 June 1985)

CHAPTER I. GENERAL PROVISIONS

Article 1.

Scope of application*

(1) This Law applies to international commercial** arbitration, subject to any agreement in force between this State and any other State or States.

(2) The provisions of this Law, except articles 8, 9, 35 and 36, apply only if the place of arbitration is in the territory of this State.

(3) An arbitration is international if:

(a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States; or

(b) one of the following places is situated outside the State in which the parties have their places of business:

(i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;

(ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or

(c) the parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one country.

(4) For the purposes of paragraph (3) of this article:

(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the arbitration agreement;

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

(5) This Law shall not affect any other law of this State by virtue of which certain disputes may not be submitted to arbitration or may be submitted to arbitration only according to provisions other than those of this Law.

*Article headings are for reference purposes only and are not to be used for purposes of interpretation.

**The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business co-operation; carriage of goods or passengers by air, sea, rail or road.

Article 2.

Definitions and rules of interpretation

For the purposes of this Law:

(a) "arbitration" means any arbitration whether or not administered by a permanent arbitral institution;

(b) "arbitral tribunal" means a sole arbitrator or a panel of arbitrators;

(c) "court" means a body or organ of the judicial system of a State;

(d) where a provision of this Law, except article 28, leaves the parties free to determine a certain issue, such freedom includes the right of the parties to authorize a third party, including an institution, to make that determination;

(e) where a provision of this Law refers to the fact that the parties have agreed or that they may agree or in any other way refers to an agreement of the parties, such agreement includes any arbitration rules referred to in that agreement;

(f) where a provision of this Law, other than in articles 25 (a) and 32 (2) (a), refers to a claim, it also applies to a counter-claim, and where it refers to a defence, it also applies to a defence to such counter-claim.

Article 3.

Receipt of written communications

(1) Unless otherwise agreed by the parties:

(a) any written communication is deemed to have been received if it is delivered to the addressee personally or if it is delivered at his place of business, habitual residence or mailing address; if none of these can be found after making a reasonable inquiry, a written communication is deemed to have been received if it is sent to the addressee's last-known place of business, habitual residence or mailing address by registered letter or any other means which provides a record of the attempt to deliver it;

(b) the communication is deemed to have been received on the day it is so delivered.

(2) The provisions of this article do not apply to communications in court proceedings.

Article 4.

Waiver of right to object

A party who knows that any provision of this Law from which the parties may derogate or any requirement under the arbitration agreement has not been complied with and yet proceeds with the arbitration without stating his objection to such non-compliance without undue delay or, if a time-limit is provided therefor, within such period of time, shall be deemed to have waived his right to object.

*Article 5.**Extent of court intervention*

In matters governed by this Law, no court shall intervene except where so provided in this Law.

*Article 6.**Court or other authority for certain functions of arbitration assistance and supervision*

The functions referred to in articles 11 (3), 11 (4), 13 (3), 14, 16 (3) and 34 (2) shall be performed by . . . [Each State enacting this model law specifies the court, courts or, where referred to therein, other authority competent to perform these functions.]

CHAPTER II. ARBITRATION AGREEMENT

*Article 7.**Definition and form of arbitration agreement*

(1) "Arbitration agreement" is an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

(2) The arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement, or in an exchange of statements of claim and defence in which the existence of an agreement is alleged by one party and not denied by another. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the reference is such as to make that clause part of the contract.

*Article 8.**Arbitration agreement and substantive claim before court*

(1) A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

(2) Where an action referred to in paragraph (1) of this article has been brought, arbitral proceedings may nevertheless be commenced or continued, and an award may be made, while the issue is pending before the court.

*Article 9.**Arbitration agreement and interim measures by court*

It is not incompatible with an arbitration agreement for a party to request, before or during arbitral proceedings, from a court an interim measure of protection and for a court to grant such measure.

CHAPTER III. COMPOSITION OF ARBITRAL TRIBUNAL

*Article 10.**Number of arbitrators*

(1) The parties are free to determine the number of arbitrators.

(2) Failing such determination, the number of arbitrators shall be three.

*Article 11.**Appointment of arbitrators*

(1) No person shall be precluded by reason of his nationality from acting as an arbitrator, unless otherwise agreed by the parties.

(2) The parties are free to agree on a procedure of appointing the arbitrator or arbitrators, subject to the provisions of paragraphs (4) and (5) of this article.

(3) Failing such agreement,

(a) in an arbitration with three arbitrators, each party shall appoint one arbitrator, and the two arbitrators thus appointed shall appoint the third arbitrator; if a party fails to appoint the arbitrator within thirty days of receipt of a request to do so from the other party, or if the two arbitrators fail to agree on the third arbitrator within thirty days of their appointment, the appointment shall be made, upon request of a party, by the court or other authority specified in article 6;

(b) in an arbitration with a sole arbitrator, if the parties are unable to agree on the arbitrator, he shall be appointed, upon request of a party, by the court or other authority specified in article 6.

(4) Where, under an appointment procedure agreed upon by the parties,

(a) a party fails to act as required under such procedure, or

(b) the parties, or two arbitrators, are unable to reach an agreement expected of them under such procedure, or

(c) a third party, including an institution, fails to perform any function entrusted to it under such procedure,

any party may request the court or other authority specified in article 6 to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.

(5) A decision on a matter entrusted by paragraph (3) or (4) of this article to the court or other authority specified in article 6 shall be subject to no appeal. The court or other authority, in appointing an arbitrator, shall have due regard to any qualifications required of the arbitrator by the agreement of the parties and to such considerations as are likely to secure the appointment of an independent and impartial arbitrator and, in the case of a sole or third arbitrator, shall take into account as well the advisability of appointing an arbitrator of a nationality other than those of the parties.

*Article 12.**Grounds for challenge*

(1) When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose any circumstances likely to give rise to justifiable doubts as to his impartiality or independence. An arbitrator, from the time of his appointment and throughout the arbitral proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him.

(2) An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his impartiality or independence, or if he does not possess qualifications agreed to by the parties. A party may challenge an arbitrator appointed by him, or in whose appointment he has partici-

pated, only for reasons of which he becomes aware after the appointment has been made.

Article 13.

Challenge procedure

(1) The parties are free to agree on a procedure for challenging an arbitrator, subject to the provisions of paragraph (3) of this article.

(2) Failing such agreement, a party who intends to challenge an arbitrator shall, within fifteen days after becoming aware of the constitution of the arbitral tribunal or after becoming aware of any circumstance referred to in article 12 (2), send a written statement of the reasons for the challenge to the arbitral tribunal. Unless the challenged arbitrator withdraws from his office or the other party agrees to the challenge, the arbitral tribunal shall decide on the challenge.

(3) If a challenge under any procedure agreed upon by the parties or under the procedure of paragraph (2) of this article is not successful, the challenging party may request, within thirty days after having received notice of the decision rejecting the challenge, the court or other authority specified in article 6 to decide on the challenge, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal, including the challenged arbitrator, may continue the arbitral proceedings and make an award.

Article 14.

Failure or impossibility to act

(1) If an arbitrator becomes *de jure* or *de facto* unable to perform his functions or for other reasons fails to act without undue delay, his mandate terminates if he withdraws from his office or if the parties agree on the termination. Otherwise, if a controversy remains concerning any of these grounds, any party may request the court or other authority specified in article 6 to decide on the termination of the mandate, which decision shall be subject to no appeal.

(2) If, under this article or article 13 (2), an arbitrator withdraws from his office or a party agrees to the termination of the mandate of an arbitrator, this does not imply acceptance of the validity of any ground referred to in this article or article 12 (2).

Article 15.

Appointment of substitute arbitrator

Where the mandate of an arbitrator terminates under article 13 or 14 or because of his withdrawal from office for any other reason or because of the revocation of his mandate by agreement of the parties or in any other case of termination of his mandate, a substitute arbitrator shall be appointed according to the rules that were applicable to the appointment of the arbitrator being replaced.

CHAPTER IV. JURISDICTION OF ARBITRAL TRIBUNAL

Article 16.

Competence of arbitral tribunal to rule on its jurisdiction

(1) The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract

is null and void shall not entail *ipso jure* the invalidity of the arbitration clause.

(2) A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than the submission of the statement of defence. A party is not precluded from raising such a plea by the fact that he has appointed, or participated in the appointment of, an arbitrator. A plea that the arbitral tribunal is exceeding the scope of its authority shall be raised as soon as the matter alleged to be beyond the scope of its authority is raised during the arbitral proceedings. The arbitral tribunal may, in either case, admit a later plea if it considers the delay justified.

(3) The arbitral tribunal may rule on a plea referred to in paragraph (2) of this article either as a preliminary question or in an award on the merits. If the arbitral tribunal rules as a preliminary question that it has jurisdiction, any party may request, within thirty days after having received notice of that ruling, the court specified in article 6 to decide the matter, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal may continue the arbitral proceedings and make an award.

Article 17.

Power of arbitral tribunal to order interim measures

Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute. The arbitral tribunal may require any party to provide appropriate security in connection with such measure.

CHAPTER V. CONDUCT OF ARBITRAL PROCEEDINGS

Article 18.

Equal treatment of parties

The parties shall be treated with equality and each party shall be given a full opportunity of presenting his case.

Article 19.

Determination of rules of procedure

(1) Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings.

(2) Failing such agreement, the arbitral tribunal may, subject to the provisions of this Law, conduct the arbitration in such manner as it considers appropriate. The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance, materiality and weight of any evidence.

Article 20.

Place of arbitration

(1) The parties are free to agree on the place of arbitration. Failing such agreement, the place of arbitration shall be determined by the arbitral tribunal having regard to the circumstances of the case, including the convenience of the parties.

(2) Notwithstanding the provisions of paragraph (1) of this article, the arbitral tribunal may, unless otherwise agreed by the parties, meet at any place it considers appropriate for

consultation among its members, for hearing witnesses, experts or the parties, or for inspection of goods, other property or documents.

Article 21.

Commencement of arbitral proceedings

Unless otherwise agreed by the parties, the arbitral proceedings in respect of a particular dispute commence on the date on which a request for that dispute to be referred to arbitration is received by the respondent.

Article 22.

Language

(1) The parties are free to agree on the language or languages to be used in the arbitral proceedings. Failing such agreement, the arbitral tribunal shall determine the language or languages to be used in the proceedings. This agreement or determination, unless otherwise specified therein, shall apply to any written statement by a party, any hearing and any award, decision or other communication by the arbitral tribunal.

(2) The arbitral tribunal may order that any documentary evidence shall be accompanied by a translation into the language or languages agreed upon by the parties or determined by the arbitral tribunal.

Article 23.

Statements of claim and defence

(1) Within the period of time agreed by the parties or determined by the arbitral tribunal, the claimant shall state the facts supporting his claim, the points at issue and the relief or remedy sought, and the respondent shall state his defence in respect of these particulars, unless the parties have otherwise agreed as to the required elements of such statements. The parties may submit with their statements all documents they consider to be relevant or may add a reference to the documents or other evidence they will submit.

(2) Unless otherwise agreed by the parties, either party may amend or supplement his claim or defence during the course of the arbitral proceedings, unless the arbitral tribunal considers it inappropriate to allow such amendment having regard to the delay in making it.

Article 24.

Hearings and written proceedings

(1) Subject to any contrary agreement by the parties, the arbitral tribunal shall decide whether to hold oral hearings for the presentation of evidence or for oral argument, or whether the proceedings shall be conducted on the basis of documents and other materials. However, unless the parties have agreed that no hearings shall be held, the arbitral tribunal shall hold such hearings at an appropriate stage of the proceedings, if so requested by a party.

(2) The parties shall be given sufficient advance notice of any hearing and of any meeting of the arbitral tribunal for the purposes of inspection of goods, other property or documents.

(3) All statements, documents or other information supplied to the arbitral tribunal by one party shall be communicated to the other party. Also any expert report or evidentiary document on which the arbitral tribunal may rely in making its decision shall be communicated to the parties.

Article 25.

Default of a party

Unless otherwise agreed by the parties, if, without showing sufficient cause,

(a) the claimant fails to communicate his statement of claim in accordance with article 23 (1), the arbitral tribunal shall terminate the proceedings;

(b) the respondent fails to communicate his statement of defence in accordance with article 23 (1), the arbitral tribunal shall continue the proceedings without treating such failure in itself as an admission of the claimant's allegations;

(c) any party fails to appear at a hearing or to produce documentary evidence, the arbitral tribunal may continue the proceedings and make the award on the evidence before it.

Article 26.

Expert appointed by arbitral tribunal

(1) Unless otherwise agreed by the parties, the arbitral tribunal

(a) may appoint one or more experts to report to it on specific issues to be determined by the arbitral tribunal;

(b) may require a party to give the expert any relevant information or to produce, or to provide access to, any relevant documents, goods or other property for his inspection.

(2) Unless otherwise agreed by the parties, if a party so requests or if the arbitral tribunal considers it necessary, the expert shall, after delivery of his written or oral report, participate in a hearing where the parties have the opportunity to put questions to him and to present expert witnesses in order to testify on the points at issue.

Article 27.

Court assistance in taking evidence

The arbitral tribunal or a party with the approval of the arbitral tribunal may request from a competent court of this State assistance in taking evidence. The court may execute the request within its competence and according to its rules on taking evidence.

CHAPTER VI. MAKING OF AWARD AND TERMINATION OF PROCEEDINGS

Article 28.

Rules applicable to substance of dispute

(1) The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of laws rules.

(2) Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

(3) The arbitral tribunal shall decide *ex aequo et bono* or as *amiable compositeur* only if the parties have expressly authorized it to do so.

(4) In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

*Article 29.**Decision making by panel of arbitrators*

In arbitral proceedings with more than one arbitrator, any decision of the arbitral tribunal shall be made, unless otherwise agreed by the parties, by a majority of all its members. However, questions of procedure may be decided by a presiding arbitrator, if so authorized by the parties or all members of the arbitral tribunal.

*Article 30.**Settlement*

(1) If, during arbitral proceedings, the parties settle the dispute, the arbitral tribunal shall terminate the proceedings and, if requested by the parties and not objected to by the arbitral tribunal, record the settlement in the form of an arbitral award on agreed terms.

(2) An award on agreed terms shall be made in accordance with the provisions of article 31 and shall state that it is an award. Such an award has the same status and effect as any other award on the merits of the case.

*Article 31.**Form and contents of award*

(1) The award shall be made in writing and shall be signed by the arbitrator or arbitrators. In arbitral proceedings with more than one arbitrator, the signatures of the majority of all members of the arbitral tribunal shall suffice, provided that the reason for any omitted signature is stated.

(2) The award shall state the reasons upon which it is based, unless the parties have agreed that no reasons are to be given or the award is an award on agreed terms under article 30.

(3) The award shall state its date and the place of arbitration as determined in accordance with article 20 (1). The award shall be deemed to have been made at that place.

(4) After the award is made, a copy signed by the arbitrators in accordance with paragraph (1) of this article shall be delivered to each party.

*Article 32.**Termination of proceedings*

(1) The arbitral proceedings are terminated by the final award or by an order of the arbitral tribunal in accordance with paragraph (2) of this article.

(2) The arbitral tribunal shall issue an order for the termination of the arbitral proceedings when:

(a) the claimant withdraws his claim, unless the respondent objects thereto and the arbitral tribunal recognizes a legitimate interest on his part in obtaining a final settlement of the dispute;

(b) the parties agree on the termination of the proceedings;

(c) the arbitral tribunal finds that the continuation of the proceedings has for any other reason become unnecessary or impossible.

(3) The mandate of the arbitral tribunal terminates with the termination of the arbitral proceedings, subject to the provisions of articles 33 and 34 (4).

*Article 33.**Correction and interpretation of award; additional award*

(1) Within thirty days of receipt of the award, unless another period of time has been agreed upon by the parties:

(a) a party, with notice to the other party, may request the arbitral tribunal to correct in the award any errors in computation, any clerical or typographical errors or any errors of similar nature;

(b) if so agreed by the parties, a party, with notice to the other party, may request the arbitral tribunal to give an interpretation of a specific point or part of the award.

If the arbitral tribunal considers the request to be justified, it shall make the correction or give the interpretation within thirty days of receipt of the request. The interpretation shall form part of the award.

(2) The arbitral tribunal may correct any error of the type referred to in paragraph (1) (a) of this article on its own initiative within thirty days of the date of the award.

(3) Unless otherwise agreed by the parties, a party, with notice to the other party, may request, within thirty days of receipt of the award, the arbitral tribunal to make an additional award as to claims presented in the arbitral proceedings but omitted from the award. If the arbitral tribunal considers the request to be justified, it shall make the additional award within sixty days.

(4) The arbitral tribunal may extend, if necessary, the period of time within which it shall make a correction, interpretation or an additional award under paragraph (1) or (3) of this article.

(5) The provisions of article 31 shall apply to a correction or interpretation of the award or to an additional award.

CHAPTER VII. RECOURSE AGAINST AWARD

*Article 34.**Application for setting aside as exclusive recourse against arbitral award*

(1) Recourse to a court against an arbitral award may be made only by an application for setting aside in accordance with paragraphs (2) and (3) of this article.

(2) An arbitral award may be set aside by the court specified in article 6 only if:

(a) the party making the application furnishes proof that:

(i) a party to the arbitration agreement referred to in article 7 was under some incapacity; or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of this State; or

(ii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or

(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which

contains decisions on matters not submitted to arbitration may be set aside; or

- (iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Law from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Law; or

(b) the court finds that:

- (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or
- (ii) the award is in conflict with the public policy of this State.

(3) An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the award or, if a request had been made under article 33, from the date on which that request had been disposed of by the arbitral tribunal.

(4) The court, when asked to set aside an award, may, where appropriate and so requested by a party, suspend the setting aside proceedings for a period of time determined by it in order to give the arbitral tribunal an opportunity to resume the arbitral proceedings or to take such other action as in the arbitral tribunal's opinion will eliminate the grounds for setting aside.

CHAPTER VIII. RECOGNITION AND ENFORCEMENT OF AWARDS

Article 35.

Recognition and enforcement

(1) An arbitral award, irrespective of the country in which it was made, shall be recognized as binding and, upon application in writing to the competent court, shall be enforced subject to the provisions of this article and of article 36.

(2) The party relying on an award or applying for its enforcement shall supply the duly authenticated original award or a duly certified copy thereof, and the original arbitration agreement referred to in article 7 or a duly certified copy thereof. If the award or agreement is not made in an official language of this State, the party shall supply a duly certified translation thereof into such language.***

***The conditions set forth in this paragraph are intended to set maximum standards. It would, thus, not be contrary to the harmonization to be achieved by the model law if a State retained even less onerous conditions.

Article 36.

Grounds for refusing recognition or enforcement

(1) Recognition or enforcement of an arbitral award, irrespective of the country in which it was made, may be refused only:

(a) at the request of the party against whom it is invoked, if that party furnishes to the competent court where recognition or enforcement is sought proof that:

- (i) a party to the arbitration agreement referred to in article 7 was under some incapacity; or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or
- (ii) the party against whom the award is invoked was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or
- (iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or
- (iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or
- (v) the award has not yet become binding on the parties or has been set aside or suspended by a court of the country in which, or under the law of which, that award was made; or

(b) if the court finds that:

- (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or
- (ii) the recognition or enforcement of the award would be contrary to the public policy of this State.

(2) If an application for setting aside or suspension of an award has been made to a court referred to in paragraph (1) (a) (v) of this article, the court where recognition or enforcement is sought may, if it considers it proper, adjourn its decision and may also, on the application of the party claiming recognition or enforcement of the award, order the other party to provide appropriate security.

II. SUMMARY RECORDS OF THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW FOR MEETINGS DEVOTED TO THE PREPARATION OF THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION

Summary records of the 305th to 333rd meetings held at the Vienna International Centre,
Vienna, 3-21 June 1985 (A/CN.9/SR.305-333*)

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*In order to facilitate the examination and understanding of the preparatory work of the Commission on the Model Law, the summary records of the relevant meetings of the Commission have been consolidated into a single volume, incorporating corrections

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305th Meeting

Monday, 3 June 1985, at 10.30 a.m.

Chairman: Mr. LOEWE (Austria)

The discussion covered in the summary record began at 11.45 a.m.

International commercial arbitration (A/CN.9/263 and Add.1-2, A/CN.9/264)

1. Mr. HERRMANN (International Trade Law Branch) reminded the Commission that the Secretary-General had transmitted the draft text of a Model Law on international commercial arbitration to all Governments and interested international organizations for comment. Their observations were reproduced in documents A/CN.9/263 and Add.1-2, except for those comments which referred to only one language version of the draft and which it was thought would best be submitted directly to a drafting group. The report containing the secretariat's commentary on the draft text (A/CN.9/264) explained the origin of certain provisions and sought to provide guidance in interpreting the text.

2. Mr. WAGNER (German Democratic Republic) said that the draft text was capable of making a major contribution to the Commission's goal of encouraging international trade relations by increasing the compatibility of national legal systems. His country looked forward to the Model Law being finalized at an early date.

3. Mr. STALEV (Observer for Bulgaria) said that his Government had had no comments to make on the draft text.

4. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that although the expertise represented on the Commission would ensure that jurisprudence and legal procedure received due attention in the consideration of the draft text, it was important to remember

that arbitrators would be the people actually using the Model Law. Specialized arbitrators had been suitably represented in the Working Group on International Contract Practices. His organization looked forward to making suggestions which it hoped would increase the practicality of the draft text and ensure that it catered properly for the requirements of arbitrators of that kind.

5. Mrs. RATIB (Egypt) said that the proposed Model Law would form a basis for effective legislation in many countries. Her delegation would comment on individual articles later.

6. Mr. EYZAGUIRRE (Observer for Chile) said that his Government had had no general comments to make on the draft. It found it generally acceptable but might ask for certain points to be clarified.

7. Mr. de HOYOS GUTIERREZ (Cuba) said that his delegation intended to make proposals during the discussion of the draft text which would consolidate suggestions already before the Commission in the written comments.

8. Sir Michael MUSTILL (United Kingdom) said that the theoretical foundation of the Model Law should not be emphasized at the expense of its practical function, which was to promote the efficient conduct of international commercial arbitration. The Commission should bear in mind the need

for parties to a commercial dispute to be free to solve it in the manner which suited them best. He therefore felt sure that it would not try to lay down hard-and-fast rules and that members of the Commission would not propose changes to the draft text unless they would improve the working of the Model Law.

9. Mr. SEKHON (India) said that his country's participation in the work on a Model Law on international commercial arbitration was in the best spirit of its Constitution, which contained a directive principle calling for international disputes to be settled by arbitration. He intended to supplement his Government's written observations during the discussion of the draft.

10. Mr. SAMI (Iraq) said that the Model Law would play an important role in standardizing international commercial arbitration procedure and would be a useful legislative guide for all countries. He hoped it would be adopted at the present session.

11. Mr. KIM (Observer for the Republic of Korea) said that the draft text was generally acceptable to his Government and many of its provisions were already part of his country's arbitration law.

The meeting rose at 12.20 p.m.

306th Meeting

Monday, 3 June 1985, at 2.30 p.m.

Chairman: Mr. LOEWE (Austria)

The discussion covered in the summary record began at 2.35 p.m.

International commercial arbitration (continued)

(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264)

Article 1. Scope of application

1. The CHAIRMAN invited the Commission to consider whether it wished the Model Law to be applied to international commercial arbitration and, if so, how were international arbitration and commercial arbitration to be defined.

2. Mr. BONELL (Italy), speaking on a point of procedure, proposed that the territorial scope of the Model Law should be clarified at that point, since it would have many implications on subsequent discussions of the text.

3. The CHAIRMAN suggested that the Commission should perhaps be allowed to discuss the draft text in order to ascertain the opinion of the representatives thereon and hence the role to be played by that text.

4. Mr. LEBEDEV (Union of Soviet Socialist Republics) reminded the Commission that a final decision had not yet been taken on whether the matter of international commercial arbitration was to be the subject of a Model Law or of a convention. Although his country had previously held a preference for a convention, its position was flexible and it was willing to accept a Model Law if that were the general view. However, a decision should be taken at the outset and duly reflected in the records.

5. The CHAIRMAN said that the decision should be left pending for the time being, but his impression was that the feeling within the Working Group was in favour of the formula of a Model Law.

6. Mr. TANG Houzhi (China) said that his country favoured a model law.

7. Mr. ABOL-ENEIN (Observer of the Cairo Regional Centre for Commercial Arbitration) said that the Centre was eager to define the scope of application of the Model Law and to have some kind of definition of the word "commercial". He also proposed that the footnote to article 1 (1) should be incorporated into the text.

8. Mr. GRIFFITH (Australia) said that they should attempt to define arbitration within the text and not by footnote. He proposed that "commercial" should be defined as "arising out of trade and commerce".

9. The CHAIRMAN said that he understood there was general agreement on article 1 (1), except for the definition of "commercial". Noting that all the statements so far had been in favour of a definition within the text, he suggested that it should be briefer than the description of what was commercial contained in the footnote, but felt that a very brief description such as "trade and commerce" would serve little purpose.

10. Mr. TORNARITIS (Cyprus) said that it was not customary to put footnotes in a draft law. Moreover, it was dangerous to attempt to define too closely: *omnis definitio periculosa est*. By definition, "commercial" was intended to refer to transactions between people in the ordinary course of commerce. If it were not closely defined, future interpreters would have to apply the ordinary meaning to it. It would, however, be better if another means were found of describing "commercial", such as "dealings in commerce and trade".

11. Mr. SEKHON (India) said that a way out of the difficulty of arriving at a comprehensive definition of "commercial" would be to append an explanation to the draft Model Law, thus leaving room for further additional interpretations.

12. Mr. EYZAGUIRRE (Observer for Chile) said that he did not favour defining the term "commercial" because it was understood in widely differing ways in different legal systems throughout the world. He considered that the footnote would serve to ensure adequate understanding.

13. Mr. RUZICKA (Czechoslovakia) said that his delegation was satisfied with the concept of "commercial" as already included in the draft Model Law. He felt it was not sufficient to give a few examples of cases of commercial transactions; the list should be expanded, although it could never be exhaustive. However, his delegation did not insist on an expanded list and would accept it as it stood.

14. Mrs. RATIB (Egypt) said that the difference between commercial and non-commercial transactions was generally understood; still, she approved the contents of the footnote as an acceptable compromise to accommodate different legal systems. It would, however, be difficult to incorporate into Egyptian law because it was not customary to include footnotes in legislation. She suggested that a definition of "commercial", without examples, should be included in article 2. Examples might usefully be given in a commentary or in an explanatory note.

15. Mr. KNOEPFLER (Observer for Switzerland) said that in drafting a Model Law it was possible to accept a more flexible approach. If the form of a convention was adopted, a precise definition in the body of the text would have a restrictive effect. For the Model Law, he favoured the system which had been used.

16. Mr. MAGNUSSON (Sweden) had doubts as to whether the Model Law should be restricted only to international arbitration, and his first choice would be to omit the words "international" and "commercial" altogether. In Sweden, there were already in existence good arbitration systems and there would be reservations about introducing new complexities based on the Model Law. However, following the lengthy discussions in the Working Group, his delegation could accept the restriction on the scope of application and the concepts of "international" and "commercial", but it was important to interpret those terms as broadly as possible. With regard to "commercial", he found it strange that the interpretation should be in a footnote and saw a risk of divergent interpretations. An attempt should be made to define the term in the text, but he was not optimistic about the possibility of success.

17. Sir Michael MUSTILL (United Kingdom) said that it was impracticable to attempt to define "commercial" precisely and it was better to be content with a general expression

in the text. If the term were to be explained outside the text, his delegation preferred it to be in a commentary rather than in a footnote. It would be open to individual States to define the term, if required; that would not be a departure from the spirit of the Model Law.

18. The CHAIRMAN said that an agreed commentary could not be achieved for practical reasons. Commentaries were really intended for the private use of delegations and contained a variety of definitions. The footnote to article 1 was in the nature of an incipient agreed commentary.

19. Sir Michael MUSTILL (United Kingdom) said that the matter was of considerable importance. He hoped that, with the assistance of the secretariat, a record of the proceedings (constituting *travaux préparatoires*) would serve as guidance to legislators.

20. Mr. HOLTZMANN (United States of America) said that the definition of the term "commercial" was a key issue. There were parts of the world where "commercial" referred only to trade transactions by merchants and where there were wide exclusions. The Model Law was intended to cover trade and commerce in the broadest possible sense. He felt that brevity was not the principal goal and might, in the circumstances, be the enemy of clarity. The footnote might be lost when the text was considered by courts. As for the *travaux préparatoires*, they would not be available to the courts. In his view, the footnote should be brought into the text because the details in question were important at the drafting stage and would serve to avoid subsequent litigation. He found the footnote as written satisfactory, but suggested two alterations. The first was to add at the end of the first sentence the words "regardless of the nature or character of the parties". The second was to expand the first item in the list of examples to read "any trade transaction for the supply or exchange of goods or services".

21. Mr. SAWADA (Japan) found the wording of article 1 acceptable. His delegation realized that the word "commercial" was ambiguous, but to define it would be impracticable. He did not feel that the addition of "trade and commerce" would clarify the matter. He suggested that examples should be included in a commentary.

22. Mr. MOELLER (Observer for Finland) said that the Model Law should be limited to international and commercial arbitration. He favoured a broad definition of "commercial" and supported the United States amendments. He felt that the footnote as drafted should be included in the text, unless that were to have a restrictive effect on the scope of the Model Law. He was not in favour of its inclusion in a commentary, since the legal effect of a commentary was even less clear than that of a footnote.

23. Mr. BONELL (Italy) supported the restriction of the scope of the application of the Model Law to international and commercial arbitration. Since there was no consensus regarding the precise meaning of "commercial", the footnote—or the report on the session—would serve as a guideline to interpret the term in the widest possible sense. He recalled that the main purpose of the work on the present topic was to achieve the highest possible uniformity in commercial arbitration throughout the world. If the term "commercial" were too closely defined, the existing national legislation would prevent certain countries from incorporating the Model Law. However he found the United States suggestion useful in that it made it clear that the commercial

character of the arbitration did not depend upon the commercial status of the parties to it.

24. Mr. EYZAGUIRRE (Observer for Chile) agreed that in legislative drafting any definition was dangerous. It might, however, be possible to work out some general criterion for inclusion in the text without resorting either to a definition or to examples. An appended note or commentary would have no force of law in his country's legal system.

25. Mr. SCHUETZ (Austria) agreed with previous speakers regarding the advantages of the form that had been adopted. The Working Group had discussed the matter at length and the text as it stood, with the footnote, seemed to offer the best possible solution. The footnote made it clear that the term "commercial" should be interpreted broadly and flexibly, which was the most important point. His delegation could accept the United States proposal to insert the words "or services" and "regardless of the nature or character of the parties", although the Working Group had decided to delete the latter concept.

26. Mr. STALEV (Observer for Bulgaria) said that the clarity and certainty required for the application of the Model Law to actual international commercial disputes could only be achieved by means of a precise definition of the term "commercial". That definition should be in the text of the Model Law itself, and the proper place for it was article 2, which dealt with definitions. Regarding the contents of the definition, he could support the additions suggested by the United States delegation. The list of contracts given in the footnote should also include contemporary contracts for international economic co-operation of all kinds.

27. Mr. ILLESCAS ORTIZ (Spain) felt that since any list of trade transactions of the kind given in the footnote would be constantly outdated and could never be complete, a conceptual approach was preferable. Article 36 of the Model Law, which related to grounds for refusing recognition or enforcement of an arbitral award, offered an opportunity to provide for exclusions.

28. Mr. TANG Houzhi (China) said that the Working Group had spent some two years discussing the term "commercial". Since it had already decided to delete the words "irrespective of whether the parties are 'commercial persons'", the present suggestion that the idea should be restored could well lead to a further two years' discussion. The Commission was unlikely to succeed where earlier efforts to arrive at an agreement had failed. The area was a sensitive one for many States and it would be better to leave the text as it stood, with the footnote, so that the draft could be finalized as soon as possible. As far as the scope of application was concerned, his delegation would prefer territorial criteria.

29. Mr. SAMI (Iraq) urged that the scope of application of the Model Law should be confined to international transactions. Since the Commission was attempting to draw up a Model Law for adoption by all States regardless of differing legal systems, it would be appropriate not to determine the meaning of the term "commercial" but rather to leave the issue to national legislations. States applied many different criteria to define commercial transactions. A list of the kind in the footnote could never be exhaustive and a number of delegations had already given examples of new commercial transactions that should be included. He would not object to maintaining the footnote since it could help to guide legislators. He would, however, oppose the proposal to include it in the text of article 1 (1).

30. Mr. PAES de BARROS LEAES (Brazil) said that it must be made clear that the Model Law was confined to international commercial arbitration. He agreed that it would be dangerous to attempt to define "commercial" in the text itself and therefore supported the listing of examples in a footnote.

31. Mr. SCHUMACHER (Federal Republic of Germany) felt that, given its importance, the term "commercial" should be defined in article 1 rather than in a footnote. At the same time, he appreciated the difficulty of finding a suitably short definition and he would not therefore oppose the footnote form. It was, however, essential to make it clear that the Law would apply irrespective of whether the parties were commercial persons or not. The phrase to that effect in the previous draft had been deleted on the grounds that it touched on the question of State immunity. However, if a State had already agreed to arbitration in a contract, the question of immunity did not arise.

The meeting was suspended at 4 p.m. and resumed at 4.25 p.m.

32. Mr. GOH (Singapore) urged that the Model Law should state clearly that it applied to international commercial arbitration. In addition, a definition of the term "commercial" somewhere in the Model Law would help to reduce disputes at a later date, when the law was in force. He believed it was not impossible to work out a satisfactory definition which should not be unduly restrictive.

33. Mr. SZASZ (Hungary) said that his delegation also would have liked a clear-cut definition of "commercial" in the text, but since it was unable to offer one it believed that it must be satisfied with the text as it stood. The footnote, or some other guidance, would be better than nothing. In Hungary, it would not have any legal standing, although he did not consider that that was its intent anyway. It would, however, have a helpful unifying effect and it was possible that other national legislations might be able to agree on a definition for inclusion in the text. Those States whose legislative techniques allowed them to put the footnote as it stood into the body of the text were, of course, free to do so. The solution put forward by the Working Group was, therefore, satisfactory. He did not favour introducing more examples since it might then appear that the list was intended to be a full definition.

34. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that his delegation too understood fully the obstacles in the way of defining the term "commercial". Given the difficulty of finding any solution satisfactory to all States, it had supported the Working Group's decision. He noted, however, that the relationships mentioned in the footnote referred only to transactions, and asked whether that meant that the Model Law would not apply to relationships not of a contractual nature. Article 7 (1) referred to a "defined legal relationship, whether contractual or not". It would be expedient to make that point in the footnote as well.

35. The analytical commentary of the secretariat, and of some of the previous speakers as well, had expressed the idea that the Model Law did not touch on the question of arbitrability, but his delegation felt that it did. Its reading of the Model Law was that it suggested that international commercial disputes could be subject to arbitration. That belief had given rise to his delegation's comment, reproduced in paragraph 9 of A/CN.9/263, which coincided with the

points made by Mexico and UNCTAD in paragraph 12. If the Model Law was in fact intended to deal with that problem, it would be necessary to add a reservation to the effect that the Law would not cover those disputes which in the State adopting the Law were not capable of settlement by arbitration. The point was made in paragraph 1 (b) of article 36, but only in connection with the grounds for refusing recognition and enforcement of an arbitral award. It should be stated in one of the opening articles.

36. Mrs. VILUS (Yugoslavia) said that her country had not been a member of the Working Group and she was not therefore familiar with all the problems encountered in trying to define the term "commercial". She was ready to support the Egyptian proposal and the additions proposed by the United States. She found the arguments in favour of a list convincing, although a definition without examples might be preferable. Since it was difficult to decide without seeing a text, she suggested that a drafting group should be set up.

37. Mr. STROHBACH (German Democratic Republic) said that his delegation did not altogether approve of the technique of leaving the explanation of the term "commercial" in the footnote but realized how difficult it would be to find an adequate solution in the near future. It was more important, therefore, to improve the footnote slightly in order to make it more precise. His delegation would support the additions proposed by the United States, together with a statement to the effect that the commercial relationships could be contractual or non-contractual. That would not be a major change and would be in line with the general approach in the Working Group.

38. Mr. ROEHRICH (France) said that the definition of "commercial" must be realistic and supported the Working Group's approach, with the additions to the footnote suggested by the United States. He did not think that the issue of arbitrability should be raised in the scope of application: it was sufficient to provide grounds for refusing recognition or enforcement under article 36. He agreed with the Hungarian representative that the footnote was indicative of the wide scope of article 1 (1) while recognizing that some States might wish to exclude certain activities, such as financing or investment, from the scope of international arbitration. With regard to the point raised by the USSR representative on non-contractual relationships, it was perhaps adequately covered by article 7 (1) and therefore need not appear also in article 1.

39. The CHAIRMAN, summing up the discussion on paragraph 1, said that the majority of speakers had favoured that paragraph being confined to the commercial field but some had wanted a slight expansion in the text of the definition of "commercial". An equal number had not favoured that proposal because they feared that it would lead to problems with domestic legislation, in which the term "commercial" was used in many other contexts; they had therefore supported the retention of the footnote. He therefore suggested, as a preliminary for further work, that the possibility should be considered of making paragraph 1 more explicit but retaining a footnote with the examples of the activities which the Commission had had in mind. The footnote might be enriched by including the proposal of the United States representative: it should also be drafted clearly to show that it was not intended to infringe State immunity. If his suggestion was accepted, the meeting might set up a small drafting group to formulate a text for the opening of paragraph 1 and for the footnote.

40. Mr. BONELL (Italy) asked what instructions would be given the drafting group with regard to a change in paragraph 1.

41. The CHAIRMAN said that he did not wish to propose any specific wording; perhaps the proposal made by the Australian representative might be considered.

42. Mr. BONELL (Italy) observed that, as an alternative to that proposal, the drafting group might consider the relevant passage in the Geneva Convention.

43. The CHAIRMAN suggested that the membership of the drafting group should consist of Mr. Szasz, Mr. Holtzmann and Mr. Tang Houzhi. If there was no objection, he would take it that the Commission agreed to set up a drafting group with that composition.

44. *It was so agreed.*

Article 1 (2)

45. The CHAIRMAN invited the meeting to consider the definition of internationality.

46. Mr. BONELL (Italy) said that his delegation had always found it difficult to regard sub-paragraph (b) (i) as a desirable criterion, although it was true, according to the secretariat commentary, that the intention was to exclude cases where the place of arbitration would be determined by the arbitrators only. However, he wondered what the result would be when the place of arbitration determined pursuant to the arbitration agreement turned out to be different from the place of business of the parties. While it remained undetermined, many issues, such as challenges, might arise and there would be uncertainty as to which law should be applied. If sub-paragraph (b) (i) was eliminated, there remained sub-paragraph (b) (ii), which was not very different from sub-paragraph (c). Paragraph 2 might therefore be revised to contain sub-paragraph (a), followed by sub-paragraph (c).

47. The CHAIRMAN said that there was not much controversy about subparagraph (a), which covered the majority of cases. Subparagraph (b) (i) covered two situations: one in which the place of arbitration had been previously determined and one in which the matter was not so certain and was perhaps subject to the decision of the three arbitrators.

48. Mr. SCHUMACHER (Federal Republic of Germany) endorsed the views of the Italian representative. His delegation supported the deletion of the words "or pursuant to".

49. Mr. HOLTZMANN (United States of America) said that the text should be left as it was. The words "pursuant to" had been included to accommodate the common situation which arose when parties chose not to specify the place of arbitration in their contract. There were several reasons for that. In some transactions, parties found it difficult to predict the nature of the disputes which might arise and felt that the most appropriate place to arbitrate could only be chosen when the issues in dispute were known. In other cases, the place of arbitration might be a source of contention in contract negotiations, and parties might find it expedient to postpone the question until a dispute actually arose. For these and other reasons it was common for some parties not to designate a place of arbitration in their contract, but to provide for such a determination to be made later pursuant to procedures established in their contract.

50. The CHAIRMAN asked whether the interpretation of "pursuant to" in the text would cover a case where, some speakers had maintained, no one would know which law would be applicable until the arbitrator had agreed to conduct the arbitration outside the countries where the parties had their places of business.

51. Mr. HOLTZMANN (United States of America) said that would be exactly the case. If he was acting as counsel for one of the parties, he would advise the place of arbitration to be determined at the outset, but if the two parties preferred to postpone that determination they should be free to do so.

52. Mr. STALEV (Observer for Bulgaria) said that the definition of "international" was too broad because it tried to combine two criteria, namely the substantive link between the subject-matter of arbitration and international trade, and the procedural test of the place of arbitration. If the latter criterion was adopted, it was clear from reading article 1 in conjunction with article 28 that a dispute involving a domestic contract for domestic goods denominated in domestic currency could, if the parties to the dispute so chose, be regulated by foreign law. It should not be possible for parties to evade the laws of their own country by submitting to arbitration abroad. The autonomy of the parties with regard to the place of arbitration was accepted in private international law when the contract had an international aspect. He therefore supported the deletion of the place of arbitration as a criterion of internationality.

53. Mr. SZASZ (Hungary) said that generally he was in agreement with the text as it stood but he thought that subparagraph (b) (i) might make the scope of application too broad. The point to be clarified was whether it was desired to make the scope of application purely territorial or whether a broader approach was desired. If the scope of application was to be territorial, it was possible to accept the present text, perhaps slightly amended. If a broader concept was adopted, then the text as it stood was dangerous.

54. Mr. ROEHRICH (France) said that his delegation supported the broadest approach. There were two important principles in international commercial arbitration, namely to give the greatest possible autonomy to the parties and to make provision for the "de-territorialization" of the relation between those parties when it came to a dispute, while

keeping matters within a reasonable framework. In his view, that would imply that the place of arbitration must play a role. On the policy to be followed as to the scope of application of internationality, the key issue had been raised by the Bulgarian representative, namely whether to have a provision like the one in the present text or not to have a provision at all. The question of whether or not to delete "pursuant to" was of relatively minor importance compared to the real problem, which was whether to give effect to the place of arbitration for determining whether the arbitration was "international" or not. In his view, from the moment that two parties domiciled in one country indicated, even if not expressly, that they wanted arbitration in another country, that fact indicated that the arbitration was international. Turning to the question of why such parties should designate a third country, he agreed it might sometimes be to avoid the application of mandatory rules existing in the country where they had their places of business. However, after the arbitration award had been made, it might still not be enforceable if it was contrary to the law of the country of residence of the parties concerned. When countries agreed that an arbitration was international, and the parties designated another country as the place of arbitration or left the decision to the arbitrator, it was appropriate to allow for those options in the Model Law. There had naturally to be some limit to the autonomy of the parties, and he therefore supported the existing text. The deletion of "pursuant to" unnecessarily circumscribed the freedom of the parties in view of the complexity in practice of such cases.

55. Mr. BONELL (Italy) said that it was necessary to distinguish clearly between two aspects: the first was whether or not to adopt the broader criterion of the scope of application or to agree that internationality might depend only on the place of arbitration being situated outside the country in which both parties had their place of business. The second and independent issue was whether to agree that the relevant place of arbitration could be determined at a later stage. He failed to understand how such a provision could work in practice owing to the uncertainty as to which court would be competent to decide many important issues, including the situation envisaged in article 8. He must insist at least on the deletion of the words "or pursuant to".

The meeting rose at 5.40 p.m.

307th Meeting

Tuesday, 4 June 1985 at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 9.35 a.m.

International commercial arbitration (*continued*)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264)

1. Mr. MAGNUSSON (Sweden) said that article 1 (2) of the draft Model Law (A/CN.9/246, annex) was sound in intention but might be improved in order to eliminate overlapping provisions. Subparagraph (b) (i), however, should remain unchanged. It covered situations commonly found in practice. It was best if the parties agreed the place of arbitration in advance, but often they did not; if the arbitrators subsequently chose a foreign place of arbitration, the Model Law should cover the situation. If the place of arbitration was not

determined by the parties, the question of applicable law would remain pending, and domestic law would apply in the meantime.

2. Mr. MOELLER (Observer for Finland) said that paragraph 2 should remain unchanged. Paragraph 2 (b) (i) would not lead to problems if the Model Law was made strictly territorial in application.

3. Mr. SCHUETZ (Austria) said that he also approved the existing text of paragraph 2. It was not unusual in private international law for purely domestic cases to become

international. The Model Law should apply as broadly as possible and include cases where the place of arbitration was in a foreign country and was determined by the arbitrators.

4. Mr. PELICHET (Observer of The Hague Conference on Private International Law) said that the words "or pursuant to" might raise practical problems. The aim was to have a broadly applicable law and to limit confusion. Other speakers had pointed to the dangers inherent in the present text, which suggested that the price of retaining paragraph 2 (b) (i) might prove high. In any case, the draft text made the place of arbitration almost a fiction, since the tribunal could meet wherever it wanted and for any purpose; it need never meet at the place of arbitration at all. That consideration removed much of the force from subparagraph (b) (i).

5. Mr. SAWADA (Japan) said that he had no difficulty in accepting the Working Group's text. If it was to be changed, however, he would prefer that paragraph 2 (b) (ii) be deleted since it was covered by paragraph 2 (c), and that paragraph 2 (b) (i) be amended to read "the place of arbitration chosen by the parties".

6. Sir Michael MUSTILL (United Kingdom) said that the words "or pursuant to" should be deleted because of the difficulties to which they might give rise.

7. Mr. HERRMANN (International Trade Law Branch) said that a distinction must be made between the territorial scope of application of the Model Law and the internationality of an arbitration. The Model Law did not seek to cover all cases where an arbitration was transferred from one country to another, but only cases so transferred which were international ones; and paragraph 2 (b) (i) answered the question whether the arbitrators in the country to which an international arbitration had been transferred would apply its domestic arbitration law or its Model Law for international arbitration. The words "or pursuant to" did admit of uncertainty in that respect because of the possibility of delay in determining the place of arbitration, but that uncertainty existed in practice and could not be removed by the Model Law. The Commission would meet the same kind of uncertainty in regard to the territorial scope of application of the Model Law.

8. Lord WILBERFORCE (Observer of the Chartered Institute of Arbitrators) said that paragraph 2 was bound to involve a measure of uncertainty. There was no problem with the many cases that would fall under subparagraph (a), but subparagraphs (b) and (c) could give rise to difficulties. The problems arising from subparagraph (b) (i) would be no greater than those inherent in other provisions. In principle, arbitrators would be able to work with it, but it would be best for the words "or pursuant to" to be deleted since they placed a heavy responsibility on the initial arbitrators.

9. Mr. GRIFFITH (Australia) agreed that the words "or pursuant to" created uncertainty and should be deleted.

10. Mr. SAMI (Iraq) said that, for the purpose of determining whether an arbitration was international, he could accept the criterion of the places of business of the parties and the criterion of the place where a substantial part of the obligations was to be performed. The place of arbitration, however, was not an essential feature of a contract and should not be an essential criterion for determining internationality. As to the deletion of the words "or pursuant to", it must be

remembered that it might be impossible to determine the place of arbitration in advance. Furthermore, to use the place of arbitration as the main criterion for determining internationality could produce a situation in which the parties, being of the same nationality, could choose internationality in order to evade the mandatory provisions of their domestic law. However important freedom of decision was in the arbitration process, that situation was unacceptable; if it arose, the country to which the parties belonged might not enable the foreign award to be enforced. The best course would be to delete paragraph 2 (b) altogether. If the Model Law was to be acceptable to all countries, it must not conflict with their legislation or sovereignty.

11. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that since the text was to be a Model Law and not a convention, it would be for each State adopting the Model Law to retain or delete the provisions of subparagraphs (b) or (c). The Model Law should include, however, a provision to the effect that it did not apply to international commercial disputes where another provision of the applicable national legislation precluded the submission of such disputes to arbitration or assigned their settlement exclusively to a specified judicial or other body. That point arose with regard to later provisions of the draft as well.

12. Mr. SEKHON (India) said that he had reservations about the lack of precision of sub-paragraph (c), which was designed to catch residual cases. Furthermore, it became inoperable when read in conjunction with the reference to a separate agreement in the second sentence of article 7 (1), since such an agreement could not be said to relate to more than one State.

13. Mr. HERRMANN (International Trade Law Branch) said that the parties' intention as to the subject-matter of the arbitration agreement should be clear from that agreement, whether the arbitration agreement was separate from the contract or in a clause in the contract itself. The Working Group had intended that the subject-matter of an arbitration agreement, whether in the former shape or the latter, should mean the area in which a dispute might arise that was then to be settled by arbitration.

14. Sir Michael MUSTILL (United Kingdom) said that it would appear from what the previous speaker had said that the term "subject-matter" in subparagraph (c) had more than one meaning. He asked whether the subject-matter of the arbitration agreement meant the obligation giving rise to a dispute or the goods or services which were the object of the contract. That consideration affected the question of the internationality of the arbitration. The words "otherwise related to more than one State" in subparagraph (c) had to be read with subparagraph (b) (ii), which referred to any place where a substantial part of the obligations was to be performed. Subparagraph (c) did not, therefore, relate to the place where the obligation was to be performed. What, then, did it mean?

15. Mr. HERRMANN (International Trade Law Branch) said that the analytical commentary (A/CN.9/264) did not include any examples for subparagraph (c) since it had been thought that most cases would come under the other subparagraphs. The wording of subparagraph (c) had been proposed by the Observer for the International Chamber of Commerce with a view to increasing the scope of article 1 (2).

16. Mr. SZASZ (Hungary) said that paragraph 2 (c) has almost unlimited scope but perhaps its wording was rather

vague. Almost all practical cases were covered by paragraph 2 (b) (ii), but if the Commission wanted paragraph 2 to be really broad in scope it would have to word subparagraph (c) more precisely. His own delegation proposed that the subparagraph should be deleted, since it referred by implication to matters with which the Commission was not competent to deal, such as the rights of multinational corporations in host countries.

17. Mr. ROEHRICH (France) pointed out that paragraph 2 (b) (ii) referred to "the obligations of the commercial relationship", whereas paragraph 2 (c) referred to "the subject matter of the arbitration agreement"; it would be more logical for the latter to speak of "the subject-matter of the dispute". The two subparagraphs did not duplicate one another. If subparagraph (c) was to be retained, it would have to be formulated more precisely.

18. Mr. HOLTZMANN (United States of America) said that a company which was performing a contract in a country other than its own would be performing one which was international in nature regardless of whether it did so through a branch office or an entity incorporated under the law of the host country. It was such cases that paragraph 2 (c) was intended to cover. It was therefore a necessary provision. To clarify this intent, a sentence might be added to subparagraph (c) to the effect that, if the parties had included in their contract a statement that the contract involved activities in more than one State, they could not deny the internationality of the contract at a later stage. Also, his Government had suggested an amendment to subparagraph (c) in its written comments (A/CN.9/263, p. 13, para. 25) to clarify that the phrase "related to more than one State" was not intended to be limited to the State itself, i.e. governmental activities, but rather to activities within a State. To accomplish this, he proposed that the provision should read "subject-matter... related to commercial activities in more than one State".

19. Mrs. VILUS (Yugoslavia) said that the provisions of paragraphs 2 (b) (ii) and 2 (c) were too broad and also vague. Although the amendments suggested by the United States representative might resolve that situation to some extent, her delegation would prefer the course of deleting paragraph 2 (c) altogether.

20. Mr. TANG Houzhi (China) agreed that paragraph 2 (c) should be deleted.

21. Mr. de HOYOS GUTIERREZ (Cuba) said that paragraph 2 (b) dealt with the matter adequately. Paragraph 2 (c) would only cause confusion and should be deleted.

22. Mr. BONELL (Italy) said that his delegation had proposed that the words "or pursuant to" in paragraph 2 (b) (i) should be deleted. If they were not, subparagraph (c) should be deleted. It was important for the Model Law to make it clear that an arbitration could not be considered international merely because one of the parties was wholly or partly owned by a foreign corporation.

23. Mr. KNOEPFLER (Observer for Switzerland) said that subparagraph (c) should be retained since it made it clear that the scope of paragraph 2 was intended to be as wide as possible.

24. Mr. MAGNUSSON (Sweden) agreed that subparagraph (c) should be retained. The notion of internationality

should bear the broadest possible interpretation, and in order to achieve that the subparagraph needed some refinement. His delegation could agree to it being worded along the lines suggested by the United States.

25. Mr. GOH (Singapore) said that subparagraph (c) should be deleted.

26. Mrs. OLIVEROS (Observer for Argentina) agreed. The wording "otherwise related to more than one State" was too unclear to be of any use, and also the subparagraph would not allow national cases to be dealt with in an international context.

27. Mr. MOELLER (Observer for Finland) proposed that a sentence should be inserted in paragraph 2 (b) (ii) to the effect that, if the parties had agreed that the subject-matter of the dispute was of an international nature, they should not be able to deny the fact at a later stage. Subparagraph (c) might then be deleted.

28. Mr. TORNARITIS (Cyprus) said that the draft text had been drawn up by experts and should not be altered unless it contained obvious mistakes or ambiguities. The United States representative had made it clear why subparagraph (c) was necessary.

29. Mr. PAES de BARROS LEAES (Brazil) said that the test of internationality was adequately defined in subparagraphs (a) and (b). Subparagraph (c) should therefore be deleted.

30. Mr. SCHUMACHER (Federal Republic of Germany) said that his delegation withdrew its written comments on the matter and recommended that subparagraph (c) be deleted.

31. Mr. GRIFFITH (Australia) said that the present subparagraph (c) should be replaced by an opting-in clause to the effect that an arbitration agreement was international if the parties specified that it was international. Such a provision would give them desirable freedom of choice. His proposal differed from that of the Observer for Finland in making the result of characterizing the arbitration agreement quite clear.

32. Mr. LEBEDEV (Union of Soviet Socialist Republics) agreed with other speakers that subparagraph (c) was vague. It was important that the Model Law should be unambiguous and therefore desirable that it should include an explicit statement concerning the arbitrability of a dispute. He proposed that a new subparagraph should be inserted between the present paragraphs 2 and 3 to the effect that the Model Law should not affect the legislation of a State by virtue of which the dispute was assigned to the exclusive jurisdiction of judicial, administrative or any other authorities, or alternatively to the effect that it should not affect the legislation of a State by virtue of which the dispute was not capable of settlement by arbitration. A provision of that kind had appeared in many international instruments.

33. Mr. GRIFFITH (Australia) supported the Soviet Union proposal and said it would suitably balance the opting-in provision which his delegation had proposed as a replacement for subparagraph (c).

34. The CHAIRMAN asked the Commission whether it wished article 1 to contain a provision along the lines proposed by the Soviet Union representative.

35. *It was so agreed.*

36. Mr. ILLESCAS ORTIZ (Spain) said that subparagraph (c) contained a general provision under which all factors of internationality could be taken into account in determining the application of the Model Law to a dispute. It therefore made the rest of the paragraph superfluous. Once the factor of internationality had been established, there would seem to be no need to refer to the place of business or to the place of performance of obligations. He would like to see paragraph 2 drafted along the lines suggested by Australia and Finland. If the parties to a dispute determined a place of arbitration other than their place of residence, that would indicate their willingness to submit the dispute to international commercial arbitration under the Model Law.

37. The CHAIRMAN said that there was a difference between paragraph 2 (b) (i) and suggested the opting-in clause. Under the former, the parties would not have taken a decision on the applicable procedural law but would simply have stated that arbitration would be in a place abroad; under the latter, however, they could determine a place of arbitration within their State and still choose the law applicable to international arbitration.

38. Sir Michael MUSTILL (United Kingdom) said that he fully endorsed the views expressed by the Soviet Union representative. He favoured the replacement of paragraph 2 (c) by an opting-in provision formulated along the lines proposed by the Australian delegation. A provision of the kind suggested by the Soviet Union would be an essential safeguard if an opting-in provision was included.

39. Mr. MAGNUSSON (Sweden) said that his first preference was for a provision on the lines of subparagraph (c), but in view of the difficulty of redrafting the subparagraph to remove its weaknesses, he would not press for its retention. He, too, was in favour of giving the parties to a dispute the freedom to decide whether it was international or not. He could accept the proposal of the Observer for Finland but would prefer that of the Australian representative. He had nothing against the addition proposed by the Soviet Union.

40. Mr. BARRERA GRAF (Mexico) expressed support for the Finnish proposal. Paragraph 2 (c) as it stood was too broad in scope. He agreed with the representative of Spain that it made paragraph 2 (b) superfluous. The Model Law should include a provision leaving the decision about the internationality of a dispute to the parties concerned, either in paragraph 2 (a) or as a separate subparagraph between subparagraphs (a) and (b) of paragraph 2. He reserved his position as to the precise way in which the Soviet Union proposal should be given effect.

41. Mr. HOLTZMANN (United States of America) said that he could support either the Finnish or the Australian proposal. In regard to the Soviet Union proposal, he favoured the second alternative.

42. Mr. ROEHRICH (France) said that the addition proposed by the Soviet Union should be a general provision in respect of the Model Law. He supported the idea of an opting-in provision as suggested by Australia. However, he regretted the fact that it would allow two parties who both had businesses in a given country to agree to resort to international law even if their transactions were devoid of any international subject-matter.

43. Mr. SZASZ (Hungary) said he strongly supported the idea of an arbitrability provision as suggested by the Soviet Union representative. He shared the concern of the representative of France about the effect of the proposed opting-in clause. States either differentiated between foreign and domestic arbitration or they did not. However, if the majority supported the proposal, he would not press his objection.

44. Mr. SAWADA (Japan) said that, while his delegation was in favour of improving paragraph 2 (c), it had reservations about the desirability of allowing the parties to decide what was international.

45. The CHAIRMAN observed that the paragraph proposed by the Soviet Union representative could restrict the effect of the proposed opting-in clause.

46. Mr. HJERNER (Observer for the International Chamber of Commerce) asked whether the Soviet Union would submit its proposal in writing, because it had important implications.

47. Mr. LAVINA (Philippines) supported the request.

48. The CHAIRMAN said that the Soviet Union representative had explained his proposal sufficiently clearly for it to be dealt with first by a drafting committee.

49. Mr. de HOYOS GUTIERREZ (Cuba) said that his delegation firmly supported the Soviet Union proposal.

50. Paragraph 2 (c) was rendered ambiguous by the word "otherwise". It should be deleted unless it could be reworded to make it clear that the subject matter of the arbitration agreement must relate directly or indirectly to more than one State.

51. The CHAIRMAN said that the Commission appeared to agree that subparagraph (c) of paragraph 2 should be replaced by a paragraph embodying an opting-in clause. It had already agreed that a paragraph on dispute arbitrability based on the Soviet Union proposal should be added to article 1. He suggested that the task of drafting those paragraphs should be entrusted to a committee composed of the Union of Soviet Socialist Republics, Finland, Australia, India and the United States of America.

52. *It was so decided.*

Article 1 (3)

53. Mr. SCHUMACHER (Federal Republic of Germany) said that the Model Law should contain a general provision on residence, something which would be important in cases where a party was not a business.

54. Mr. SEKHON (India) said that the word "relevant" in the second line of the paragraph was redundant in view of the expression "For the purposes of paragraph (2) of this article" and the article "the" preceding this word. It therefore needed to be deleted.

55. The CHAIRMAN suggested that article 1 (3) should be redrafted accordingly by the drafting committee which had just been set up.

56. *It was so agreed.*

57. Mr. HOLTZMANN (United States of America) drew attention to his Government's written suggestion, mentioned in A/CN.9/263 (p. 8, para. 3) that the Model Law should express the principle of *lex specialis*. He asked if the drafting committee might consider the matter in connection with the Soviet Union proposal.

58. *It was so agreed.*

Article 2. Definitions and rules of interpretation

59. The CHAIRMAN invited the Commission to consider the definitions and rules of interpretation.

60. Mr. STROHBACH (German Democratic Republic) proposed that the words "whether *ad hoc* or in arbitration administration by an institution" should be added to subparagraph (a).

61. Mr. HERRMANN (International Trade Law Branch) pointed out that article 7 (1) used the words "whether or not administered by a permanent arbitral institution" in order to make the clarification which the representative of the German Democratic Republic sought to add to subparagraph (a). He suggested that, in order to meet the suggestion of the German Democratic Republic, the Commission might wish either to use the wording in article 7 (1) or simply make a reference to that article.

62. Mr. STROHBACH (German Democratic Republic) said that he felt the clarification should be spelt out expressly in the definitions.

63. *It was so agreed.*

64. Mr. PELICHET (Observer for The Hague Conference on Private International Law) said that his organization had made a written comment on subparagraph (c) to the effect that the subparagraph could not be reconciled with article 28, on rules applicable to the substance of a dispute. He reserved the right to raise the matter under that article and pointed out that it might involve redrafting subparagraph (c).

65. Mrs. RATIB (Egypt) said that article 2 should include a general reference to arbitral awards.

66. Mr. RUZICKA (Czechoslovakia) referred to his Government's written proposal on subparagraph (e), mentioned in A/CN.9/263 (p. 15, para. 4), and suggested that wording should be added at the end of the subparagraph to the effect that mailing by registered letter was sufficient to ensure that arbitration could begin.

67. Mr. GRIFFITH (Australia) expressed concern about subparagraph (e) in the light of Norway's written comments on it, mentioned in A/CN.9/263 (p. 15, para. 6). He suggested that the subparagraph should include provision for advertising if no address was found after reasonable enquiry and should stipulate that communications were to be deemed to be received on the day on which they were delivered. He also suggested that consideration should be given to Norway's written proposal for the Model Law to provide a right of recourse or appeal for a party to an arbitration who, through no fault of his own, had not received notice.

The meeting rose at 12.35 p.m.

308th Meeting

Tuesday, 4 June 1985 at 2.30 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 2.35 p.m.

International commercial arbitration (continued) (A/CN.9/246, annex; A/CN.9/263 Add. 1-2, A/CN.9/264)

Article 2. Definitions and rules of interpretation (continued)

1. Mr. GRIFFITH (Australia) said his delegation had felt that subsection (e) should perhaps deal with the question of a substitute service when it was known that the addressee was not at his last known business address or habitual residence. However, on reflection, he considered it more appropriate to raise that issue in connection with article 11 (4).

2. Mr. STROHBACH (German Democratic Republic) supported the Czechoslovak proposal that subparagraph (e) should state that written communication could be made by registered letter. It was also not clear to whom the addressee's place of business, habitual residence or mailing address was supposed to be known: was it to the other party or to the arbitrator? If it was the latter, was it incumbent on him to contact the police, the business registration office or some

other authority? In his view, the intention had been to refer to the last address known to the other party. If so, it should be clearly stated in subparagraph (e).

3. Mr. de HOYOS GUTIERREZ (Cuba) agreed that some clarification was required in the wording of subparagraph (e). In particular, the phrase "after making reasonable inquiry" seemed inappropriate. He would suggest a phrase along the following lines: "after having established that reasonable enquiries had been made", so that if there was an appeal by the addressee, evidence could be produced that a real effort had been made to contact him.

4. The CHAIRMAN said he did not feel it necessary in a Model Law on arbitration to enter into details about notification, which was a subject more appropriate for a code of civil procedure. If it was desired to expand subparagraph (e), perhaps it would be better to convert it into a separate article on notification.

5. Mr. STALEV (Observer for Bulgaria) thought that the matter was important since it was closely connected with the right of parties to be heard. He therefore strongly supported proposals which went to guarantee that the addressee actually received the communication. He endorsed the Chairman's suggestion of a separate article on notification.

6. Mr. ROEHRICH (France) noted that a Model Law should deal with basic principles. It should not go into too many details, which could give rise to difficulties with national legislations on procedure. The point of substance was that reasonable attempts should have been made to inform the addressee so that he had an opportunity to exercise his rights. Language to that effect appeared in a number of international conventions. It would be difficult to go any further and try to obtain agreement on precise rules.

7. Sir Michael MUSTILL (United Kingdom) supported the comments of the French representative.

8. Mr. SAMI (Iraq) agreed that the procedure under subparagraph (e) might have important legal implications in view of the fact that arbitration on international commercial disputes often involved considerable sums of money. It was therefore difficult to accept the present text: the mere dispatch of a communication was insufficient. The communication should be made by registered mail and a certain period of time should elapse before the addressee could be taken to have received it.

9. Mr. SCHUETZ (Austria) agreed with the views expressed by the French representative. The present text took into account the interests of both parties and was not prejudicial to the addressee.

10. Mr. BARRERA GRAF (Mexico) suggested that article 2 should contain the definition of arbitration agreement which at present appeared in article 7 (1). It was also necessary to include in article 2 some definition of the concept of "award", which was used in article 16 (3) and article 34 (1).

11. Mrs. OLIVEROS (Argentina) said there was no need to enter into details about notification in the Model Law. Most legal systems, whether common law or civil law, contained adequate provisions for that purpose. She supported, however, the Mexican representative's suggestion to incorporate in article 2 a definition of "award".

12. The CHAIRMAN said that subparagraph (e) should achieve a balance between the interests of the party sending the communication and the party receiving it and also a balance in the text, so that it was neither too detailed nor too brief. He therefore suggested that a small drafting group should be set up to reword subparagraph (e), composed of the representatives of Czechoslovakia, France, Iraq and Mexico.

13. There had also been a proposal to add two other definitions to article 2. Definitions of the terms in question did appear in the 1961 Geneva Convention but they now made rather strange reading.

14. Mr. HERRMANN (International Trade Law Branch) recalled that when the Working Group had discussed article 7 (1) it had had before it two draft versions, one in the form of a definition, which had become the present text, and the other closer to article 11 (1) of the 1958 New York

Convention. There were advantages in leaving article 7 (1) in its present form. The provisions in article 7, paragraphs 1 and 2, and in article 8 (1) would appear in the same order as in the New York Convention.

15. Mr. TORNARITIS (Cyprus) enquired whether the intention was that States should adopt the Model Law as it stood or adapt it to their municipal legal systems. He observed that definitions in a legal text usually related to the specific meanings which should be attributed to particular words for purposes of that text and which they did not have in ordinary language. As for subparagraph (e) of article 2, it should constitute a separate article; it was not a definition.

16. The CHAIRMAN observed that the Model Law would be used according to the requirements of the country concerned. States which did not have rules on international arbitration might take the Model Law as it stood; others would modify it in conformity with their general rules of law. Article 2 contained definitions in subparagraphs (a) and (b) and rules of interpretation in the remaining subparagraphs. The proposal to incorporate the definition of arbitration agreement in article 2 did not appear to have attracted much support. As to the question of defining "award", he felt that such a definition would be useful but doubted whether it would be practical in view of the range of concepts which it covered.

17. Mr. HERRMANN (International Trade Law Branch) said that the Working Group had at various times attempted to define arbitral award but had not been satisfied with the results. In that connection, he read out the definition contained in the report of the Working Group on its 7th Session (A/CN.9/246, paras. 192 and 193). He himself would venture to caution against the inclusion of a definition as such, which would be intended to apply to all the instances in which the term was used in the Model Law. The only matter that should be regulated was that of what decisions could be set aside under article 34. Following the example of the 1958 New York Convention, which also did not define an arbitral award, no attempt should be made to define it for the purposes of articles 35 and 36. The definition of the type of decision that could be set aside under article 34 might be "any decision which contained a decision on substance". Any decision which was strictly on a procedural matter, including the competence of the arbitral tribunal, would not be covered by article 34. However, it would be seen that for those procedural matters where court assistance or supervision was deemed appropriate (as in articles 11, 13 and 14), the Model Law provided for special court intervention, the object of which was, unlike in article 34, the matter itself, namely appointment of arbitrator, justification of challenge or of termination of mandate due to failure to act. There remained the issue of article 16 (3). There would probably be a discussion on whether to retain that text in its present form, according to which a court review on the decision of the arbitral tribunal which affirmed its competence was envisaged only in an action for setting aside the arbitral award and the intention was that it should be available in conjunction with the procedure set out in article 34 (2).

18. Mr. de HOYOS GUTIERREZ (Cuba) pointed out that in Spanish the word "*tribunal*" referred to an ordinary court, whereas an arbitral tribunal was called a "*corte*". Similarly, there were several words for award, including "*auto*" to refer to a decision which did not settle a question of substance.

19. Sir Michael MUSTILL (United Kingdom) said that if definitions were to be omitted, the inconsistencies of termino-

logy in the existing draft must be eliminated. For example, article 16 (3) referred to "rule", whereas article 20 (1) and article 22 (1) had "determine" and article 24 (1) and article 25 mentioned "decision". It was necessary to go through the text to see where, if anywhere, differences in language were required in order to indicate differences in concept. Furthermore, the phrase "final award", used in article 32, was nowhere defined. Article 34 was the prime location for the term "award", but consideration would have to be given to the meaning of that word in article 31. Should a procedural decision take that form? Was it to be a reasoned decision and need it be in writing? Another point was whether article 33 was applicable to awards other than the final award, which constituted the subject matter of article 36. A further unresolved issue was the question of interim awards. Some confusion had arisen because there were two connotations of the term. The first was an award made before the final award dealing, for example, with procedure and not with merits. The second was an award dealing with the merits but only with part thereof. It was very common in international arbitration, particularly in cases in which a decision had first to be taken on liability before proceeding to an assessment of the damages. If the decision was negative, the interim award might well constitute the only award. In that case, did it fall within the scope of article 34? Perhaps that question, which must be solved, would be better dealt with when considering article 34.

20. Mr. BONELL (Italy) reminded the Commission of the difficulties faced by the Working Group in attempting to define "arbitral award". He agreed with the proposal that there should be no initial general definition. Where the need for a specific definition was identified in the text, a decision could be taken at that time.

21. Mr. HOLTZMANN (United States of America), referring to article 32 (1), said that it would be necessary to consider the matter of various kinds of awards in addition to final awards. A distinction might have to be made between interlocutory awards, whereby the tribunal ruled on such preliminary matters as jurisdiction or the finding of liability, and partial awards, whereby damages were awarded on one part of a claim but other issues remained to be decided. The term "interim award" referred to an award on such matters as interim measures of relief. All of these terms were found in article 32 of the UNCITRAL Arbitration Rules.

22. Mrs. RATIB (Egypt) said that the Commission really needed to specify in article 34 which types of award could be set aside.

23. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that the reason for defining "award" would be to facilitate the identification of measures which were subject to review or enforcement. The approach suggested by the secretariat, however, was more promising. If "award" were not defined, then there would be no need to define interlocutory, partial and other awards.

24. Mr. SEKHON (India) said that there was no need to define "award".

25. The CHAIRMAN said that subparagraph (e) of article 2 would be redrafted by the small drafting group he had suggested earlier. That concluded the discussion of article 2 for the time being, but if there were a need to define terminology arising in the course of consideration of the text

of the draft Model Law, it would be possible to make additions to article 2. If there were no objections, he would take it that the Commission agreed to adopt those suggestions on article 2.

26. *It was so agreed.*

Article 4. Waiver of right to object

27. Mr. SEKHON (India) wished to make two points. First, article 4 took away a valuable right. Secondly, the words "ought to have known" and "without delay" were too vague and likely to give rise to controversy. He suggested that the former phrase should be elaborated by adding "by use of ordinary diligence" and that a time-limit should be specified to replace the latter.

28. Mr. SAMI (Iraq) said that article 4 was ambiguous and contained a number of difficulties. In Iraq, for example, substantive matters in arbitration agreements could always be the subject of objection without any time-limit. In arbitration, which was the amicable settlement of a dispute, it was necessary to guarantee the freedom of the parties and not introduce differences stemming from ignorance of the law, the arbitration agreement or other matters on the part of one or other of the parties. While the parties undertook to use arbitration in accordance with the arbitration agreement, future imponderables would be outside their contemplation and they could therefore not set fixed deadlines. As to the expression "without delay", it was unduly vague. The addition of the references to diligence and timely objection would still leave full latitude to the parties. For those reasons among others, his delegation proposed that article 4 should be deleted.

29. Mr. HJERNER (Observer for International Chamber of Commerce) said that an article of that type was useful. Parties wishing to object should do so in proper time. However, he thought that the scope was too wide; the concept of constructional knowledge reflected in the words "ought to have known" went too far. To apply that rule to non-mandatory provisions was too strict. With regard to mandatory provisions, it was not well-founded, since if a party wished to object, he should do so at the beginning of the proceedings.

30. Mr. ROEHRICH (France) said that article 4, as drafted, could not be transferred into certain national legislations. Since many national judicial systems contained rules relevant to the matter, it might be sufficient to indicate that existing civil procedures should be used. Perhaps it might be possible to identify those articles in respect of which the right to object could be exercised and define the procedure there.

31. Mr. MATHANJUKI (Kenya) said his delegation had reservations relating to article 4 arising in particular from the dispatch and receipt of communications referred to in article 2 which might affect the knowledge of a party. He did not see any provisions relating to instances when an appellate court could reopen all or certain questions settled by a tribunal, provisions which might be affected by those in article 4. His delegation wished to see article 4 qualified to take account of those matters and could not accept it as it stood.

32. Mr. MOELLER (Observer for Finland) said it was useful to provide for a general waiver. A party could not wait until a later stage, such as after the award, in order to object.

33. Mr. HOELLERING (United States of America) said his delegation supported the policy of including a general provision, since it was difficult to define every instance within the Model Law. Although the words "without delay" were vague, it was difficult to set a time-limit in advance; that matter could be decided by the arbitral tribunal or court in each case. He felt the rule should relate only to non-mandatory provisions, otherwise it might be too severe. The words "knows or ought to have known" should be included, and he supported the addition of wording such as "using ordinary diligence". In his view, the waiver extended to subsequent judicial proceedings.

34. Mr. BONELL (Italy) said that the basic principle in article 4 was unimpeachable since it was a well-known general principle of law. However, he was uncertain as to the ultimate usefulness of the provision, since there were already several exceptions to it in the draft Model Law, such as article 16 (2). Other exceptions might already be contained in national procedural laws. He suggested that the Commission should adopt a functional approach and consider independently each specific occasion where failure to object might preclude a party from raising objections at a later stage.

35. Mr. STALEV (Observer for Bulgaria) said he was in favour of article 4 in principle, subject to possible minor corrections, since the main principle was already contained in the UNCITRAL Arbitration Rules. There was a need in international commercial relations for good faith, timeliness and stability.

36. Mrs. RATIB (Egypt) said that she approved the article in both substance and form. The text corrected the severity of the presumption it established, leaving the judge the ability to appreciate the elements composing it.

37. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that the same principle was contained in the UNCITRAL Arbitration Rules, article 30; it was also widespread in national legislations, but there would be advantage in achieving uniformity by retaining article 4, which he strongly supported.

38. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that the theoretical principle underlying article 4 was an aspect of consent. It provided that the parties might consent to waive their right to object. Arbitration was a consent procedure, and it was therefore right that such an article should be included. It was also important to tell a lay arbitrator, who was not a lawyer, that parties who had not objected in due time had waived their right to do so. Greater uniformity would be achieved by retaining article 4, since national legislations were likely to introduce more technicality and diversity. He also suggested, for the sake of uniformity, that the words "ought to have known" should be omitted in order to bring the article into line with the relevant UNCITRAL Arbitration Rule.

39. Mr. ABOUL-EINEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) said that article 4 reflected sound existing principles; he therefore supported its retention but felt that further clarification was required in order to avoid ambiguity.

40. Mr. SZASZ (Hungary) reminded the Commission that the terms of reference of the Working Group were to refer to the UNCITRAL Arbitration Rules and the 1958 Convention and there was therefore no reason for a radical departure

from them. He also suggested that the wording of the Model Law should be reviewed with a view to achieving closer uniformity with the UNCITRAL Rules.

41. Mr. SEKHON (India), in answer to those opposed to the retention of article 4, suggested that some of the severity of the article could be mitigated by giving power to the court or arbitral tribunal to exercise discretion, where there had been unreasonable delay, in deciding whether there were sufficient reasons for that delay.

42. Mr. LAVINA (Philippines) said he supported the retention of article 4, which was based on an established and valid concept in law, subject to the refinement of certain sentences.

43. Mr. GRIFFITH (Australia) said his delegation supported the retention of article 4.

44. The CHAIRMAN said that the majority view was clearly in favour of retaining article 4 in some form. He invited the Commission to consider possible amendments to the drafting. He recalled that objections had been made to the phrase "ought to have known".

45. Mr. HJERNER (Observer for the International Chamber of Commerce) said that the rule in article 4 should apply to objections to any provision of the Model Law.

46. The CHAIRMAN said that the general feeling in the Commission was in favour of specifying those provisions of the Law from which the parties might derogate. It had been suggested that the phrase "ought to have known" should be deleted.

47. Mr. HUNTER (Observer for the International Bar Association) said that the wording used in the UNCITRAL Arbitration Rules was preferable; the words "or ought to have known" should be deleted.

48. The CHAIRMAN took it that there was general agreement that the phrase should be deleted. He invited the Commission to consider next the phrase, "without delay", in the French text "*promptement*". The Indian delegation had suggested that the arbitrators should be given discretion to condone a delay for sufficient reasons. He pointed out, however, that if the rule in article 4 were to hold good for later judicial proceedings, the State courts would be bound by the discretion of the arbitrators.

49. Mr. HERRMANN (International Trade Law Branch) said that the idea in the Working Group had been that the waiver should go beyond the arbitral proceedings proper, although that was not expressly stated in the article. The question of raising an objection later than "without delay", as in the Indian suggestion, would still come within the arbitral proceedings.

50. The CHAIRMAN pointed out that if the arbitrators used their discretion to refuse to extend the time period, the State court concerned in the setting-aside proceedings would lose the power of control and supervision referred to in article 6.

51. Sir Michael MUSTILL (United Kingdom) said he could find no provision in the Model Law requiring objections to be made within a specific time. Article 33, which set a time-limit, was not concerned with procedural objections. If there was no time-limit, the phrase had no purpose.

52. Mr. HERRMANN (International Trade Law Branch) said that when article 4 was drafted it had been assumed that it would refer to non-compliance with the arbitration agreement or the arbitration rules, which often contained such time-limits.

53. Sir Michael MUSTILL (United Kingdom) said that, in English law at least, such indefinite expressions as "without delay" and "promptly" introduced an element of flexibility. It could be, therefore, that discretion was not really needed.

54. The CHAIRMAN suggested that it would be sufficient to say "without unreasonable delay", on the understanding that the phrase would be interpreted first by the arbitrators and then by the State court which might be asked to set aside any award.

55. Mr. SZASZ (Hungary) said that imprecise words such as "unreasonable" caused problems and that the words "without delay" sufficed.

56. Mr. BONELL (Italy) suggested that the word "undue", as used in the 1980 Vienna Convention, would give the desired flexibility.

57. Mr. GRIFFITH (Australia) said that two relevant time periods were involved. There was no provision in article 4 for extending the time-limit provided for in the arbitration agreement. Perhaps the article should pick up the provision in article 23 of the UNCITRAL Arbitration Rules and provide for the extension of the time-limits if justified.

58. Mr. HERRMANN (International Trade Law Branch) said that there were few exact time-limits set in the draft as the Working Group had thought it appropriate to give the arbitral tribunal wide discretion, as expressed in article 19 (2). He believed that article 4 was not as rigid as it seemed.

59. Mr. ROEHRICH (France) said that, as he read it, article 4 left it to national legislation to set a time-limit for stating an objection. Clearly, some time-limit must be fixed. That was a minor point, however. The most important point in respect of article 4 related to its application before the State courts which were the subject of article 6. He found it hard to accept that a court seized under article 34 with an application for setting aside an award should be bound by a time-limit for making objections to a procedural defect in the arbitration proceedings.

60. It ought, perhaps, to be made clear, for those who believed that the provisions of article 4 should apply to post-award proceedings in the State courts, that the fact that an objection had not been made within a certain time limit would have no consequence. It should, in fact, be clearly

stated that article 4 applied only to the arbitral proceedings. In other words, it was unnecessary to envisage sanctions at the State level, given that the main purpose of State court intervention was to control the application of the mandatory provisions of the Model Law.

61. The CHAIRMAN said he could not agree that all the provisions of article 34 (2) applied to the violation of mandatory provisions of the Law. For example, the State court had a margin of judgement in considering whether the arbitral tribunal had fully respected the right of the party making the application to present his case. He agreed, however, that if mandatory provisions only were involved, article 4 would have no effect in the setting-aside proceedings. Without having the Commission go into the question of determining which provisions of the Model Law were mandatory and which non-mandatory—a task that would be infinitely time-consuming—he noted that, if the time-limit was made flexible by using a term such as "undue delay", the State court would be able to determine for itself the time-limit that should have been respected. Then, even if the arbitrators ruled that the normal time had been exceeded and the court then found that, in the circumstances, a normal time had not been exceeded, it would be able to control the regularity of the arbitral procedure, as provided for in article 34.

62. Mr. SAWADA (Japan) wished to repeat his Government's comment that the effect of a waiver of the right to object (under article 4) should extend to subsequent judicial proceedings.

63. Mr. BONELL (Italy) said that the representative of France had drawn attention to an important shortcoming of article 4, in that it failed to state which provisions were non-mandatory and which mandatory. Regarding the relationship between article 4 and articles 34 and 36, he agreed with the comment by Japan that if article 4 was accepted, the effect of the waiver should rule in any later proceedings. It would be appropriate, therefore, when the Commission arrived at the consideration of articles 34 and 36, to establish a link with the provisions of article 4.

64. The CHAIRMAN took it that the Australian representative did not wish to press his proposal, as that would mean a complete reworking of the text. If so, the Commission had completed its deliberations on article 4. It would be unnecessary to appoint a drafting group for the other changes which had been suggested and had been noted by the secretariat. If there were no objections, he would take it that the Commission agreed to approve article 4 with those changes.

65. *It was so agreed.*

The meeting rose at 5.30 p.m.

309th Meeting

Wednesday, 5 June 1985, at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 9.40 a.m.

International commercial arbitration (*continued*)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264)

Article 5. Scope of court intervention

1. Sir Michael MUSTILL (United Kingdom) said that judicial control of the arbitral process was a topic of prime

importance. The United Kingdom's position on the subject was set forth in its written comments, reproduced in A/CN.9/263/Add.2, and he did not propose to restate it. Everyone would agree that some measure of judicial intervention was inevitable in the field of arbitration and that the concept of a Model Law would be meaningless without courts to enforce its provisions. Differences of opinion on the

matter in the Commission were concerned more with the timing of judicial intervention than with whether it should exist at all. The only purpose of the Model Law was to help the businessman, who might need a court to help him remedy the occasional injustice that inevitably occurred in any dispute-resolving mechanism. It was essential that the businessman, the arbitrator and the lawyer should know exactly what article 5 meant, but as it had pointed out in its written comments, the United Kingdom did not.

2. The first problem arose from the opening words of article 5: "In matters governed by this Law", which were intended to convey the meaning that the Model Law did not regulate all the circumstances in which the courts and the arbitral process might come into contact. In practice, therefore, what matters did the Model Law govern? As he understood it, it was not the intention of the draftsmen that article 5 should be interpreted as stating that the remedies the Model Law provided were exclusive only for matters it dealt with expressly, or that where the Model Law did not deal expressly with a particular matter, the court should have a free hand or there should be no possibility of a remedy.

3. He drew the Commission's attention to the example given in para. 21 of A/CN.9/263/Add.2 of a factual situation not expressly covered by the Model Law. The first possibility referred to in that paragraph was that the draftsmen of the Model Law had decided that the situation should not be dealt with by the Model Law and could therefore be redressed through domestic law. The second possibility was that they had decided that there should be no power of judicial intervention in the situation concerned. The third was that the situation had not been considered at all. He did not see how a reader of article 5 who did not have access to the *travaux préparatoires* could ascertain what his position might be under the article. If the provision was not clear to persons other than those who had drafted it, it was a failure. The United Kingdom had not proposed an amendment to article 5 because it believed that the meaning of the provision had never been fully debated. He had raised the problem for discussion by anyone interested. He would like to hear from the secretariat, on whose initiative the article had been introduced, what the first phrase of article 5 meant. He had noted with interest the secretariat's comment (A/CN.9/264, p. 19, para. 4) that the words in question were intended to refer to matters "expressly or impliedly" regulated by the Model Law, but he was uncertain as to how that interpretation would operate in practice.

4. A second question was how to deal with abuse of the arbitral process. The Model Law appeared to contain no provision for intervention during the actual arbitration: article 34 dealt with intervention after the award and article 36 with defensive intervention at the stage of execution, but the Model Law was silent on the possibility of the court intervening before the award. The Commission should consider whether the omission of a reference to judicial intervention during arbitration meant that the subject was not covered by the Model Law, or that such intervention was implied, or that it was excluded; and whether it wished the Model Law to deal with the questions at all.

5. He also wished to raise the question of contracting out of article 5. The fundamental principle of the Model Law was to recognize the autonomy of the parties. The parties could choose the procedures they wanted, and he had learned from the previous day's debate that they could choose to apply the Model Law even in a field where there was no international commercial dispute. It was a misconception that the businessman wanted to rule out all judicial control. The United

Kingdom was not in favour of deleting article 5, but it was not for the Commission to tell the businessman what he wanted: the Commission was there to serve him.

6. Mr. HERRMANN (International Trade Law Branch) said that the United Kingdom representative, in referring to the difficulties which arose in deciding whether a particular situation fell within the scope of article 5, had brought out the clear distinction which existed between two related but separate problems: namely, what matters were and were not governed by the Model Law; and the extent of judicial control envisaged in it. On the second point, there had been a slight divergence of opinion in the Working Group on International Contract Practices. There seemed to have been a clear understanding that the purpose of article 5 was not to deal with the extent of judicial control but to oblige the draftsmen of the Model Law, or, at a later stage, the national legislator, to decide what would be the situations in which court control should be provided. Regarding the words "In matters governed by this Law", problems of interpretation and application were not unique to article 5; even without it, the question would arise as to which of the three possible interpretations mentioned by the United Kingdom was the correct guide to the application of the Model Law.

7. In regard to the question of express or implied provisions, it was impossible for the Model Law to deal expressly with every procedural instance that might arise in arbitral proceedings. Article 19 (2), for example, gave arbitrators a certain discretion in the conduct of arbitral proceedings and was meant to cover, without spelling them out, a wide range of procedural circumstances that might occur. Again, the Model Law contained a provision allowing the parties to agree on a procedure for appointing arbitrators, but under a certain domestic law there was a rule that even arbitrators appointed by the parties had to be confirmed by the local court; that question of confirmation was not dealt with expressly in the Model Law, but in his opinion the provision that the parties were free to agree on the arbitrators clearly implied that they could actually appoint them.

8. The United Kingdom had dwelt on the difficulties which might arise in deciding how to read article 5 in a situation concerning which nothing was found in the Model Law. There might of course be nothing in the Model Law about a specific situation, but in that case it would be necessary to look at the provisions of the Model Law dealing with the area out of which the situation had arisen. He agreed that decisions on individual cases would be very difficult to make, but he doubted whether the Model Law could go beyond using the words "In matters governed by this Law".

9. The United Kingdom's written comments included the question (A/CN.9/263/Add.2, para. 25) whether it was really the intention of the Model Law that article 5 should operate to exclude judicial control in situations not foreseen by the Working Group on International Contract Practices. That was obviously not its intention because the list of matters which the Working Group had decided not to deal with in the Model Law was clearly given by way of example only (A/CN.9/246, para. 188).

10. Mr. LAVINA (Philippines) said that his delegation supported the principle underlying article 5 because it would prefer that court intervention in arbitral proceedings should be avoided as far as possible. The article nevertheless raised problems. For example, if the Model Law was enacted in national legislation, it would be a *lex specialis* and therefore take precedence over other domestic law. An awkward situation would then arise if article 5 conflicted with

provisions of national constitutions or fundamental laws in regard to areas of jurisdiction.

11. Mr. SEKHON (India) said that his delegation endorsed the United Kingdom's objections to article 5 but would not like to see it deleted. It was important that the Model Law should find wide acceptance in different countries. In India, for example, judicial control of arbitration was sometimes exercised by the Supreme Court. In the states, the High Courts under article 227 exercised superintendence and control over various tribunals, including arbitral tribunals. Those controls should not be removed. His delegation could accept article 5 if it was modified to enable parties to opt out of it.

12. Mr. GOH (Singapore) said that his delegation was not happy with article 5. There should be some judicial control over the conduct of arbitration proceedings and over the parties to an arbitration, to prevent abuse of the arbitration process. In his opinion, article 5 should either be deleted or be amended to reflect that principle.

13. Mr. SCHUETZ (Austria) said that he found fewer problems with article 5 than the United Kingdom representative. Its purpose was not to imply that court intervention was undesirable or should be kept to a minimum but to make it clear that there should be no court intervention except in the cases provided under the Model Law. In order to allay the doubts that had been voiced about the meaning of the words "In matters governed by this Law", he suggested that they should be deleted; that would not harm the article. The correct place to strike a balance between the independence of the arbitral process and the need for judicial intervention in it was in the special provisions. The Commission might usefully consider whether to increase the possibilities for court intervention in special fields in the knowledge that the purpose of article 5 was to make it clear that no court should intervene in the arbitral process except as provided in the Model Law.

14. Mr. STALEV (Observer for Bulgaria) said that article 5 should remain as it stood because it reflected the need for speedy international arbitration. To date, over seven arbitration cases had been decided by the Bulgarian Chamber of Commerce and Industry's Arbitration Court and as yet no need had been felt for judicial control over the conduct of its proceedings. In his opinion, extensive judicial control might delay arbitral proceedings and go against the interests of international trade.

15. Mr. KIM (Observer for the Republic of Korea) drew attention to the wording proposed by his Government for article 5 in its written comments (A/CN.9/263, p. 16, para. 2). The present wording of the article was insufficiently broad to cover matters of international commercial arbitration not governed by the Model Law.

16. Mr. BONELLI (Italy) said that he appreciated the points made by the United Kingdom representative. His delegation was nevertheless strongly in favour of retaining the present article 5, because court intervention in the arbitral process, particularly if it was international, should be kept to a minimum. More important, the cases where it was permitted should be stated clearly, so that the position was known to those concerned from the outset. The provision in article 5 would not be binding on States, and they would be able to interpret it when incorporating it into their national legislation.

17. He noted the written comment of the United Kingdom (A/CN.9/263/Add.2, para. 37) that the Model Law should set a

minimum of judicial control, whereas he had always understood that the purpose of article 5 was to set a maximum. Perhaps the Commission should consider that question.

18. Mr. SZASZ (Hungary) said that the underlying issue was the unification not merely of procedural law but of all kinds of law. There was, therefore, no simple answer as to what matters were covered by article 5. The members of the Council for Mutual Economic Assistance, for example, followed the rule that when their unified law did not cover a particular point, the domestic law of the seller's country would apply. The Commission could do no more than recognize that article 5 raised the whole issue of the problems of unification. The article did not deal with the question of how broad court control should be, and it should not be attacked on that ground. If the Commission wanted some degree of unification, then article 5 was acceptable; if not, the article was open to criticism. His delegation favoured the retention of the article, for the Model Law must make it clear to the reader exactly where the limits of court control lay. He agreed with the observation made by the United Kingdom about the view which the secretariat had expressed in its commentary with regard to the scope of the article (A/CN.9/264, p. 19, para. 4); there again, the problem was one affecting all matters of unification.

19. Mr. HOLTZMANN (United States of America) said that the United Kingdom had raised the question of what matters were covered by the Model Law. He was not sure that the wording of article 5 could be improved in that respect. It was his country's general policy that court intervention during arbitration proceedings should take place only in rare cases since it could cause great delay. As to the United Kingdom suggestion that parties have the right to opt out of article 5, should they be able to opt out of it in regard to the entire arbitration process or only part of it? In any case, it would be difficult for the parties to state exactly what they were opting out of. The Commission would not be helping businessmen by adding a further complication to an already complicated process.

20. Mr. MOELLER (Observer for Finland) said that the principle underlying article 5 must be supported: the Model Law must try to prevent abusive court intervention, especially during arbitration proceedings, and be clear as to the cases in which court intervention was permitted. It might be better to replace the words "In matters governed by this Law" with the admittedly narrower provision "During the course of the arbitration proceedings".

21. Mr. HJERNER (Observer for the International Chamber of Commerce) agreed that the principle underlying article 5 was a very important element of the Model Law. The possibility and extent of court intervention had a great influence on the choice of the place of arbitration. Mr. Hermann had implied that the circumstances of court intervention should be spelled out in national law, but if that allowed broader intervention than the Model Law, the aim of the latter—to assure potential users that its procedures were adequate—would be frustrated. States should therefore try to avoid changing the Model Law in that respect.

22. It might be possible for the wording of article 5 to be improved. The meaning of intervention, for example, was not clear; a distinction must be made between intervention and assistance. If, during the proceedings, an arbitral tribunal requested court assistance, for instance with respect to the production of a witness, that did not amount to intervention. The question of intervention also concerned article 18, which should not be interpreted to mean that the ordinary courts could not order interim measures.

23. Mrs. RATIB (Egypt) said that her delegation favoured the retention of article 5 despite the difficulties inherent in the question of court control. By limiting such control to the cases covered by the Model Law, the Commission would bring some order to the disparity of national legislations and make arbitration proceedings less complicated. The exclusion of matters not covered by the Model Law established a balance whereby the difficulties mentioned by some States might be overcome.

24. Mr. ROEHRICH (France) said that the merit of the United Kingdom submission was that it made the Commission think about the extent of the unification achievable through a Model Law. The Model Law must have a clear policy with respect to court intervention, which must be limited to the essential matters which it covered. The Commission's ambitions with regard to unification must be modest, for article 5 would not prevent courts from intervening in matters not covered by the Model Law.

25. The Observer for the International Chamber of Commerce had drawn attention to the need to distinguish between intervention and assistance. It was clear to his delegation that article 5 covered all acts in national courts, whether mere requests for assistance or applications for decisions directly affecting the arbitration proceedings. With regard to the idea of allowing the parties to opt out of article 5, his country did not think that national legislation should allow the parties to waive recourse to national jurisdiction or even agree to it. If the national law provided such recourse, it should remain available regardless of the wishes of the parties.

26. The existing wording might be the best that could be formulated for article 5. His objection to the Austrian suggestion to delete the words "In matters governed by this Law" was that their retention would leave the position clearer. The version of the article proposed by the Observer for the Republic of Korea was interesting but might create more problems than it solved. It might be useful for the draft to include a provision to the effect that the Model Law did not prejudice the right of States to provide remedies in their national legislation which were not in the Model Law.

27. Mr. TORNARITIS (Cyprus) said that some countries, including his own, might have constitutional difficulties with respect to article 5. In Cyprus, the judicial power was exercised by the courts under the jurisdiction of the Supreme Court. The establishment under the Model Law of an arbitral tribunal involving curtailment of the rights of local courts might be found unconstitutional.

28. Mr. SAMI (Iraq) said that his delegation supported article 5 because the courts should be available as a last resort to safeguard the rights of the parties. Article 5 guaranteed the parties equality by giving them the right to go to court in the specific cases provided in the Model Law. That provision would be very important if an arbitral tribunal could not resolve a dispute or if one of the parties could not accept its decision. Recourse to a local court would then be quite normal. He agreed with the representative of France that the article covered requests for a court's assistance. If the Commission decided to delete article 5, it would leave the door wide open to court intervention under national legislation. The merit of the article was to define the sphere of such intervention clearly and in a way which made it unnecessary to reword it.

29. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that the attitudes of delegations to article 5 were determined by their view of what the users of the Model Law wanted. Some users were more

afraid of abuses by other parties than of court intervention, while others feared abuses by arbitrators. Article 5 could not solve that problem. The Commission had to decide how broadly such matters ought to be dealt with in the Model Law. A solution might lie in the use of wording such as "unless otherwise agreed" or "if the parties so agree".

30. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that the problems which had arisen during the discussion of article 5 revealed the different concepts of arbitration which existed in different countries. All delegations were convinced of the importance of party autonomy, but some considered that the authority of the court should be preserved in order to avoid injustice, whereas others felt that the parties to an arbitration must accept the unavoidable risks which it involved that adjudication by a court did not. His delegation did not share the opinion that the article set a minimum judicial control over arbitration and would prefer to see an even lesser degree of judicial control provided for; however, the status of the text as a Model Law would leave each State free to decide that matter for itself. It was important to consider what relationship the Model Law would have with existing national legislation on judicial intervention after its adoption.

31. The present wording of article 5 was acceptable and followed that of many other international instruments. The Asian-African Legal Consultative Committee had suggested in its written comments (A/CN.9/263/Add. 1, p. 6) that the title of the article should be changed to "Limitation of court intervention". His delegation would prefer it to read "Limits of court intervention". The question could be discussed further in connection with other articles, especially article 34.

32. Mr. PAES de BARROS LEAES (Brazil) said that court intervention in an arbitration should be kept to a minimum. Article 5 adequately expressed that valuable principle in its present form.

33. Mr. TANG Houzhi (China) said that court intervention could be understood to mean assistance, which should be provided as fully as possible, or control, which should be kept to a reasonable minimum. Article 5 should be retained, although the wording might be improved in the light of the written comments of the United Kingdom.

34. Mr. de HOYOS GUTIERREZ (Cuba) said that parties to an arbitration had expressly chosen to come before expert arbitrators rather than before the courts and that consequently courts should not have the right to intervene in arbitration cases. Article 5 should be retained.

35. Mr. JEWETT (Observer for Canada) said that in that part of Canada in which civil law operated, article 5 would not be necessary, and in the part governed by common law, it would be difficult to enforce. Measures to prevent court intervention had often failed because of the power wielded by the court. However, his delegation could support article 5 if it was amended to make it clear when judicial intervention was permissible.

36. Mr. ABOUL-ENEIN (Observer, Cairo Regional Centre for Commercial Arbitration) expressed support for article 5 in its existing form. A change in the wording would be acceptable if it did not alter the meaning of the text.

37. Mr. BONELL (Italy) said that it had been proposed that the opening words of the article "In matters governed by this Law" should be deleted; there was also the suggestion that they should be replaced by the words "During the course of the arbitration proceedings". Neither formulation was accept-

able to his delegation. A further suggestion had been that the words "unless otherwise agreed", referring to agreement between the parties, should be added at the end of the article. That too would cause his delegation difficulties.

38. Sir Michael MUSTILL (United Kingdom) said that the problems which arose in connection with article 5 could not be solved merely by drafting changes. His delegation considered that the present version of the article, while not perfect, was the best which could be hoped for.

39. Mr. HOLTZMANN (United States of America) said he felt that a drafting group consisting of experts, including perhaps the United Kingdom representative himself, might be able to improve the article.

40. The CHAIRMAN said that although the article might seem inflexible, States when enacting the Model Law were not obliged to follow it to the letter. The fact that the area which it governed was not defined precisely gave arbitrators and judges a certain amount of discretion. Most delegations had agreed with the French representative that it should be understood to cover assistance from the courts as well as judicial intervention proper. The article had found general approval and he therefore felt that the Commission would wish it to be maintained in its existing form.

41. *It was so agreed.*

Article 6. Court for certain functions of arbitration assistance and supervision

42. Mrs. RATIB (Egypt) proposed that article 6 should be amended to read "The Court with jurisdiction to perform the functions referred to in this Law . . .".

43. The CHAIRMAN observed that the text of the article should properly begin "The Court or Courts . . .".

44. Mr. STROHBACH (German Democratic Republic) said that article 6 should not be interpreted as an indication of the competence of the court, particularly in cases of multiple competence. The article was referred to in later articles and should be expanded to include the criteria for assigning jurisdiction, such as the place of arbitration, the place of business of the defendant or the habitual residence of the arbitrator.

45. Mr. SZASZ (Hungary) said that the issue really at stake was the territorial scope of the Model Law, which should be decided by the Commission for the text as a whole rather than for article 6 alone.

46. Mr. HERRMANN (International Trade Law Branch) said he felt that the Commission should settle the various questions concerning the territorial scope of the Model Law straight away. The secretariat had summed the matter up in paras. 4-6 of its comments on article 1 (A/CN.9/264, p. 7). Most members of the Working Group on International Contract Practices had been in favour of the strict territorial criterion, but a minority had considered that the parties should be allowed some freedom to select the law governing their arbitration. The 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards acknowledged the existence of both criteria in national law, but in practice parties rarely took advantage of their autonomy of choice of law where it existed.

The meeting rose at 12.35 p.m.

310th Meeting

Wednesday, 5 June 1985, at 2.30 p.m.

Chairman: Mr. LOEWE (Austria)

The discussion covered in the summary record began at 2.40 p.m.

International commercial arbitration (continued)

(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264)

Article 6. Court for certain functions of arbitration assistance and supervision (continued)

1. The CHAIRMAN said that the question of territoriality had been raised by the secretariat in connection with article 6. If it was the Commission's feeling that there was an important problem in that connection, a decision could perhaps be reached and, if necessary, a text prepared.

2. Mr. HERRMANN (International Trade Law Branch) said that a number of difficulties arose when arbitration proceedings were held in one country under the procedural law of another: for example, in the taking of evidence or in applying for the annulment of an award. The general feeling in the Working Group had been that in terms of the competent court, the procedural law of the place of arbitration should prevail. The choice of any other criterion could lead to unmanageable situations. It was felt that it would be appropriate to state the principle explicitly in the Model Law, particularly since the 1958 Convention on the Recognition

and Enforcement of Foreign Arbitral Awards envisaged the existence of both the territorial system and the party autonomy system.

3. Mr. HOLTZMANN (United States of America) said that the law of the United States assumed that the procedural aspects of an arbitration, whether concerning the arbitrators or judges in connection with the arbitration, would be the law of the seat of arbitration. He recognized that in some States there were laws which, in the interests of party autonomy, said that the parties could choose another procedural law, first in the procedures to be followed by the arbitrators and secondly, to some degree, in the procedure followed by the courts. Nevertheless, there was an inherent limitation, even where States permitted the parties to use the procedural law of their choice. They could not, for example, import into one State from another State something which violated the second State's public policy. As the secretariat had noted, the simplest approach would be to have those States which adopted the Model Law be in the same position as the vast majority of States, which was that, if an arbitration was conducted in their territory, in so far as a procedural law governing the subject of arbitration existed there, that law

should be followed by the arbitrators and by the courts. That would greatly simplify the task of drafting the Model Law. If both territoriality and party autonomy were to apply, all the various circumstances would have to be defined. That was why the Working Group had favoured a strict territorial principle, and why his delegation continued to do so. He felt that it would be wise to state the principle clearly in the Model Law at an early stage.

4. As far as article 6 was concerned, his delegation agreed with the remarks of the German Democratic Republic and with the written comments of the Soviet Union pointing out the problems that would arise in regard to the role of the courts in the appointment of arbitrators or in dealing with challenges in the event that the commercial contract had not specified the place of arbitration. It would be wise to provide specifically for one place and one court in a situation of that kind, in which a defendant refused to facilitate the arbitration by appointing an arbitrator. In such circumstances, where one of the parties would not appoint an arbitrator and no place had been agreed on, the plaintiff should be able to turn to his own court to appoint an arbitrator for the defaulting defendant. It could logically be argued that either place would be appropriate in a situation of that kind, but it would be simpler to pick the court of the plaintiff for dealing with such problems as appointment and challenge. A provision to that effect should therefore be added to article 6. It was not essential to decide on the territorial question for the moment, but he agreed with the secretariat that it would be wise to reach a decision rapidly.

5. Mr. ROEHRICH (France) agreed largely with the United States position but felt that it might not be appropriate to have a general provision affirming strict territoriality. Room should be left for party autonomy and for recognition that, in a given State that had adopted the Model Law, the parties could choose another law for the arbitration although, as far as the assistance and supervision of the State court was concerned, territoriality must apply. The Commission should examine the draft article by article to see if it was necessary in each case to provide for territoriality. As he felt, that need existed in article 6, and above all in article 34 (1), where a choice would have to be made between the two phrases left in square brackets, "in the territory of this State" and "under this Law". It was clear that, for the court functions mentioned in article 6, the territorial criterion should be specified, and he therefore supported the proposal of the German Democratic Republic.

6. Mr. BONELL (Italy) said that his delegation's basic assumption was that the Model Law was intended to apply only and exclusively to arbitral proceedings taking place within the territory of the enacting State, i.e. the so-called territorial approach. It believed, therefore, that article 6 should be understood as indicating that the court of the State in which the arbitration took place was competent in the matters specified in the article. In his delegation's written comments on the jurisdiction of the State court (A/CN.9/263, p. 17, para. 1), attention had been drawn to the still-open question of what would happen if cases of the kind envisaged in articles 11 (3), 11 (4) and 13 (3) arose before the place of arbitration had been determined. Accordingly, article 6 needed to be drafted so as to cover such hypothetical cases. A possible solution would be a provision similar to that in the Italian Code of Civil Procedure, which provided in such cases for the competence of the court of the place where the arbitration agreement or the contract containing the arbitration clause had been concluded. His delegation attached great importance to the inclusion of such a provision in article 6, since otherwise the whole mechanism would not function satisfactorily.

7. A number of other interesting aspects had been raised in connection with article 6. It was true that the 1958 New York Convention did not explicitly state the territorial criterion, or the principle of party autonomy, but there was no reason why it should have done so since its aim was simply to regulate the execution of foreign awards. Article 1 of the New York Convention was significant in that respect, since it recognized that there was no uniformity as to the criteria for defining the nationality of arbitral proceedings. It referred to the most common case, that of an arbitration taking place abroad, but stated that the Convention also applied to "arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought". The Model Law was more ambitious in seeking to cover not just the recognition and enforcement of foreign awards but all possible international arbitral proceedings. It was intended to go beyond procedural issues *strictu sensu*, where the parties should be enabled to enjoy the greatest possible autonomy, and to act as a kind of constitutional law for international commercial arbitration. It therefore had to clarify whether the principle of party autonomy could still be admitted in so large an ambit. His delegation's view was that it should not, and possibly could not. Accordingly, the territorial approach should be adopted on an exclusive basis. The Commission could, however, show a certain flexibility in adopting that approach. It could avoid laying down the principle in a general fashion, and settle the matter only where it must inescapably be dealt with, as in article 34. His delegation, therefore, was open-minded. It would not object if the territorial criterion was not spelt out from the beginning, but, as far as substance was concerned, that should be the only criterion in determining the application of the Model Law.

8. Mr. BROCHES (International Council for Commercial Arbitration) said that there seemed to be a general feeling that the Commission should look at each instance separately and that it was not yet time to formulate a general provision. While it was not necessary to do so in the case of article 6, the discussion had awakened an awareness of the problems that lay behind it. Opinions could be strong on some issues, for example in connection with article 34, regarding the power of a court to set aside an award not made under its law on the grounds that it was made within its territory. France, for example, held that an international award could be annulled if it was made in France. From the practical point of view, it was important for the parties to know where they could turn for judicial assistance or to lodge an appeal. A stage had been reached where the actual place of arbitration was becoming more and more of a fiction. For instance, in a case involving a French company and a Turkish company, the International Chamber of Commerce had decided that the place of arbitration should be Austria. Until an action for annulment was brought in Austria, the whole proceedings had actually taken place in France. The Commission would have to consider to what extent a distinction might have to be made between the place of arbitration for purposes of enforcement or annulment, and for other stages of the proceedings. All those complications would have to be kept in mind as the Commission went through the draft.

9. Mr. MOELLER (Observer for Finland) agreed that it was time for the Commission to try to decide whether it should have as its starting point a strictly territorial scope or the approach that the parties should be free to subject their arbitration to a law other than the law of the place of arbitration. Finland, for example, would like to change its current procedure and accept the territorial criterion because of the extreme complications that could arise under the other system. It would be helpful if the Commission could reach agreement on whether or not to adhere to the territorial concept so as to avoid difficulties at a later stage.

10. Mr. SZASZ (Hungary) said the Commission should consider the practical situation of a judge in a country where the Model Law had been adopted as part of the national legislation and the parties had selected the procedure of another country for their arbitration proceedings. If that judge was approached by one of the parties, what should his attitude be towards the mandatory rules of the Model Law? The Commission must take up a position on the subject of territoriality and then see how it would apply in the various articles. There would have to be exceptions, but there must be a clear-cut approach. His delegation offered to adopt the concept of strict territoriality to start with.

11. Mrs. RATIB (Egypt) said that Egypt wished to make its position clear on two matters connected with the problem of territoriality. The first was the autonomy of the parties to choose the rules of procedure for their arbitration. Exception made of public policy, Egypt would oppose any restraint on that freedom which might oblige the parties to apply the procedure of the place of arbitration or restrict their right to adopt rules of procedure from other sources of their choice. In article 34, the question of territoriality was covered by two phrases in square brackets. In that case, Egypt opted for territoriality, i.e. the maintenance of the phrase "in the territory of this State" and the deletion of the other phrase "under this Law". The latter phrase could in fact give national courts competence to rule on the validity or otherwise of a decision made outside their territory. Such extraterritorial competence was not acceptable for a number of countries unless it was on a reciprocal basis.

12. Mr. LAVINA (Philippines) endorsed the recommendation of the Working Group. He believed that the principle of territoriality was both logical and practical. An eclectic criterion would lead to confusion and delay in arbitration proceedings. The autonomy of the parties was desirable, but in the case under consideration, it had to be related to some other basic issues such as public policy in the State of the place of arbitration. Opting for the procedure of another State might cast doubts on the soundness of local procedural law. There was also the question of sovereignty. Normally, legislation had an exclusively territorial application.

13. Mr. KNOEPFLER (Observer for Switzerland) said that in cases where the parties had not previously determined the place of arbitration, the United States proposal was interesting. He was less favourable to the idea of selecting the place where the contract or arbitration agreement had been concluded since it rarely had any link with the substance of the contract. He favoured the principle of territoriality but did not wish it to be opposed to the autonomy of the parties. They should not be prevented from choosing certain rules of procedure of a country other than that of the place of arbitration. His delegation favoured territoriality in order to avoid a positive conflict of jurisdiction.

14. Mr. SCHUMACHER (Federal Republic of Germany) said he shared the majority view that the decisive factor should be the place of arbitration, because articles 27 and 34 of the Model Law dealt with the role of the courts. They could only be the courts of the State in which the arbitration took place and they would always apply their own procedural law. That meant that the courts of a State in which the Model Law did not apply could not be obliged to fulfil the functions envisaged in articles 27 and 34. Agreement of the parties to apply the law of another State could relate only to the arbitral tribunal in so far as it kept within its functions as such. For that reason, and in the interests of certainty, he favoured the territorial criterion at least as far as the possible functions of national courts were concerned. A decision on territoriality should be made immediately in respect of article 6.

15. The CHAIRMAN said that the majority appeared to favour strict, but somewhat toned down, territoriality. Once the place of arbitration was determined, the courts of the State in question were competent. The Commission must decide later who should be competent to appoint arbitrators when the place of arbitration had not yet been determined. The participants also seemed agreed that such a decision did not prevent the parties from choosing the procedure of another State, at least as far as the arbitration proceedings themselves were concerned.

16. Mr. HOLTZMANN (United States of America) said he must enter a reservation with respect to the broad statement that the parties could agree to adopt the procedure of a State other than that of the place of arbitration. For his delegation, that must be subject to the proviso that the foreign procedure was not contrary to United States public policy and did not violate United States laws. Possibly other delegations might share that view.

17. Mr. HJERNER (Observer for the International Chamber of Commerce) said that territoriality was a simple principle, but simplicity was not the only virtue. In international arbitration, where State agencies were often involved, both the parties and the arbitration procedures were more sophisticated. The parties might choose the procedure of a State other than that of the place of arbitration, or opt for general principles or for some other combination. The wishes of parties in that regard should be fully respected, not only in respect of the arbitration proceedings themselves but also with regard to the possibility of challenging those proceedings on the grounds that the arbitrators had not complied with local law.

18. Mr. ROEHRICH (France) noted the Chairman's statement that the court designated by the State of the place of arbitration was competent but that that did not prevent parties from choosing a different procedure. He thought that statement should be supplemented by the observation that it in no way prevented the courts of the State whose law had been chosen by the parties for the arbitration proceedings from declaring that they were competent. That might not be stated as a rule, but the formulation adopted should not exclude that possibility.

19. The CHAIRMAN said he would be most reluctant to insert into the Model Law rules on the subject of disputed jurisdiction. If that course was followed, the Commission would end up attributing to each jurisdiction the competence it already possessed. He hoped that the Commission would be able to agree upon a Model Law, it being understood that the arbitrators would apply the rules the parties wished unless the rules conflicted with the public policy of the State to which the parties would have to turn for the annulment or enforcement of the award. Experience with the Geneva Convention showed how undesirable it was to enter into very great detail.

20. Mr. HOLTZMANN (United States of America) said it seemed to be the view of some speakers that the national law to be followed by the arbitrators could be selected by the parties but that the law to be followed by the courts could not. In fact, an example would show that there could be no such dichotomy. He would suppose that the parties wished to designate Austria as the place of arbitration but selected United States procedural law. The United States Arbitration Act provided that an arbitrator might administer an oath to a witness and that he might also issue a subpoena. Consequently, the appropriate penalties for perjury and contempt of court were also applicable. In many civil law countries, such powers on the part of the arbitrator would violate national law.

21. Mr. BONELL (Italy) endorsed the Chairman's view that the Model Law should not include rules about disputed jurisdiction. Obviously, the Model Law must contain criteria to determine its territorial scope, which the majority had supported. However, within that framework, much of the Model Law was not intended to be mandatory. The parties were free to determine the procedure for the arbitration proceedings proper, as expressly stated in article 19, and indeed in respect of other aspects of the arbitration.

22. Mr. SAMI (Iraq) said that freedom of the parties was an admirable concept but there could be no freedom without some limitation. As the discussion had made clear, the parties were free to choose their own procedure for the arbitration proceedings but they could not impose a law on the national courts of their chosen place of arbitration.

23. The CHAIRMAN said that the discussion now centred on the extent to which parties had the right to choose their own procedure. With regard to the point raised by the United States delegation, he thought that Austria—or some other countries—would not admit certain acts by arbitrators when they exceeded the powers attributed to arbitrators by national legislation. On the other hand, although Austrian law did not recognize written testimony, if arbitration proceedings were being conducted according to a foreign procedure which did admit it, written testimony would probably be regarded as admissible since it was neither coercive nor contrary to public policy. Generally, it would probably be possible to apply about 90 per cent of the foreign procedure chosen by the parties concerned. The question of disputed jurisdiction, raised by the French representative, was a current problem which the formulation of a rule was unlikely to solve. As an illustration, he would take the case of an award in an arbitration held in the Federal Republic of Germany but under Austrian procedural law. In Germany (where the law chosen by the parties was the test) the award was deemed a foreign award and in Austria (where the place of arbitration was the material element) it was also a foreign award and could not be set aside. However, it would be enforced everywhere as a foreign award.

24. He suggested that the secretariat should be requested to draw up a memorandum on the principles on which agreement had been reached, namely strict territoriality but with the possibility of agreement to apply the legislation of some other State provided it did not impinge on the functioning of the national courts and was not contrary to public policy in the State of the place of arbitration. Such a memorandum would be useful when the Commission considered other articles of the Model Law. Article 6 was perhaps not the appropriate place to consider it since it had been designed for other purposes. He therefore hoped that the Commission could agree to article 6 fixing the territorial competence of each State which accepted the Model Law, taking account of the decision on territoriality and extra-territoriality which had just been reached.

25. Mr. SAWADA (Japan) said that his delegation could accept the Chairman's summary as just restated, namely that the choice by the parties of an arbitral procedure should not derogate from the judicial powers of the State where the arbitration took place.

The discussion covered in the summary record was suspended at 4.55 p.m. and resumed at 5 p.m.

26. The CHAIRMAN made a drafting suggestion following what had been foreseen as a memorandum by the secretariat. It had been suggested that the system of territoriality would

operate with difficulty in certain situations where no place of arbitration had been determined. Therefore, it was perhaps inappropriate to mention articles 11 (3), 11 (4), 13 (3), 14 and 34 (2). He suggested that the text should be amended to read "to perform the functions referred to in this law" and then in the articles in question an exception would be introduced with the proviso that it was a real exception which did not contradict the general rule stated in article 6.

27. Mr. HERRMANN (International Trade Law Branch) said that the idea of listing those articles in article 6 together with the court functions envisaged was to make it clear that the proposal to designate one or more special courts for that purpose only applied to those functions and not to other court functions in the Model Law, such as those envisaged in articles 8, 9, 27, 35 and 36. The purpose of article 6 was to centralize matters at a specialized court; it would, for example permit certain urgent matters, such as appointment and challenge, to be heard by only one person such as the President of the court. Those considerations did not apply to other functions.

28. Mr. LEBEDEV (Union of Soviet Socialist Republics) raised the question of which bodies should perform the functions of assistance and supervision under article 6. He felt that those functions should not be restricted to a court. More flexibility would be achieved by envisaging that some functions, such as appointment, removal or challenge of arbitrators, might be attributed to bodies other than a court, such as a chamber of commerce or trade association, as appropriate under the national legislation of each State. In that context, the UNCITRAL Arbitration Rules permitted the designation of any competent body or authority. His delegation proposed that article 6 should contain an indication that a court or other competent body could be given jurisdiction in respect of those functions, as it had already suggested in its written submissions.

29. Mr. PARK (Observer for the Republic of Korea) said that his delegation accepted the provisions of article 6 in principle but foresaw two problems. First, there were doubts as to whether article 6 was mandatory, since where there was an agreement between the parties as to the competent authority, that agreement should be respected. Where there was no such agreement, the court should be designated by the enacting country. The draft Model Law did not make that point clear, and it should therefore be clarified. Secondly, where there were several competent courts agreed between the parties or designated by the State, it was not clear which court would exercise the functions under article 6. He proposed the addition of a second paragraph to establish that where more than one court had jurisdiction under the first paragraph, jurisdiction should be exercised by the first court with which the parties or the arbitrator had dealt.

30. The CHAIRMAN invited the Commission to consider first the USSR delegation's proposal to give the States adopting the Model Law a broader choice in assigning the functions mentioned in article 6 by amending the opening words "The Court" to read "The Court or another competent organ" (A/CN.9/263, p. 18, para. 9).

31. Mr. MTANGO (United Republic of Tanzania) said that he did not agree with the majority view on the territorial scope of application. He supported the proposal that the functions mentioned in article 6 should be assigned to the court or another competent organ.

32. Mr. SAMI (Iraq) said that he supported the proposal to assign the functions mentioned in article 6 to the court or

another competent organ, since that would allow more flexibility to States in designating the competent institutions.

33. Mr. de HOYOS GUTIERREZ (Cuba) said he supported the USSR proposal to give the States adopting the Model Law a broad choice in assigning the functions mentioned in article 6, because that would accord with the situation in Cuba, where the law on arbitration assigned those functions to the international arbitral tribunal attached to the Chamber of Commerce. He suggested that the text of the proposal should be more precisely elaborated.

34. Mr. HJERNER (Observer, International Chamber of Commerce) said that the proposal to allow the designation of courts or any other competent organs to exercise the functions set out in article 6 would make the Model Law somewhat more realistic. A State adhering to the Model Law was unlikely to accept the idea that only one court could be designated, particularly where there were several legal systems, as occurred in federal States. It was realistic to attribute those functions, which were mainly directed to the appointment and challenge of arbitrators, to bodies such as a chamber of commerce. It was less likely, however, for a chamber of commerce to be empowered to set aside an award. With regard to article 13, the International Chamber of Commerce was concerned that where the parties agreed upon a challenging procedure before an arbitral institution such as, for example, that of the International Chamber of Commerce, then the decision of that institution should be final and there should be no further recourse, e.g. to a local court.

35. Mr. MAGNUSSON (Sweden) said that it was convenient to attribute the functions set out in article 6 to institutions other than courts and he therefore had no objection to the proposal under consideration. However, it did not necessarily follow from article 6 that only one court could be designated. According to the commentary, countries were free to designate several courts. It was also open to individual countries to decide whether appeal to a higher court would be allowed from decisions of the court or tribunal of first instance.

36. The CHAIRMAN invited the Commission to consider whether in situations where the parties agreed that the challenge should be decided upon by another body such as a chamber of commerce, the decision of that body was binding or whether appeal to a court should be allowed.

37. Mr. MAGNUSSON (Sweden) said that if the parties designated a particular body then there could be no appeal, since the choice would have been made by the parties' own will. However, if the challenge were made within the normal judicial system of the country, such as in a district court, then the decision should be subject to appeal to a higher court.

38. Mr. ROEHRICH (France) said that the proposal to give States a broader choice in assigning the functions mentioned in article 6 was acceptable, since it gave flexibility in the face of differences in national legislative bodies. However, he preferred the phrase "competent authority" to "organ" in order to reflect the relationship with the legislation of the State. The effect of the proposal on article 13 could be

discussed when that article was considered. However, although courts or other bodies might be appointed by States to exercise the functions in article 6, that did not perhaps mean that other bodies had the same status as courts and that their decisions should therefore be subject to appeal to a higher court. He also felt that to increase flexibility in article 6 might result in further complications in interpreting later articles.

39. He explained that if the principle of allowing the designation of a body other than a court was extended to the remainder of the Model Law, there would be no reason to make a distinction between courts and other authorities provided that they were permitted to act under the relevant national legislation. He suggested that it should be expressly stated in article 6 that designations made under that article should be in accordance with national law.

40. Mr. MOELLER (Observer for Finland) said that he supported the proposal that article 6 should refer to the court or another competent organ; if that organ, however, was not part of the judicial system, then that fact should be mentioned in the article. The question raised in connection with article 13 as to whether the parties could agree to exclude the court by designating a body outside the judicial system was something that should be discussed when that article was reached.

41. Mr. STALEV (Observer for Bulgaria) asked if the proposal to authorize institutions other than courts to perform the functions set out in article 6 would also apply to the setting aside of an award, since he felt that such was not the intention of the proposal under consideration.

42. Mr. LEBEDEV (Union of Soviet Socialist Republics) reminded the Commission that full details of his delegation's proposal were set out in their written submission (A/CN.9/263, p. 18, para. 9). The proposal related specifically to the functions set out in articles 11, 13 and 14 concerning the appointment, challenge and substitution of arbitrators. Clearly, it was within the competence of each State to appoint an appropriate authority to fulfil those functions. However, it would be useful to state that fact in the Law, thus stressing the element of flexibility and thereby making the draft Model Law more attractive to States.

43. Mr. SEKHON (India) supported the proposal to give States a broader choice in assigning the functions mentioned in article 6. He also supported the view that where a court was not designated, the body appointed should be a competent authority.

44. The CHAIRMAN said that if there were no further comments, he would take it that the Commission agreed to adopt the proposal that States should be given a broader choice in assigning the functions mentioned in article 6; care should be taken to word the relevant passage on the basis of the USSR written proposal (AC/CN.9/263, p. 18, para. 9).

45. *It was so agreed.*

The meeting rose at 5.40 p.m.

311th Meeting

Thursday, 6 June 1985, at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 9.35 a.m.

International commercial arbitration (continued)

(A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264)

Article 6. Court for certain functions of arbitration assistance and supervision (continued)

1. Mr. PARK (Observer for the Republic of Korea) referred to the remarks he had made at the previous meeting with regard to the court authorized to exercise the functions mentioned in article 6 (A/CN.9/SR.310, para. 29). He wished to emphasize his point that it should in the first place be the court agreed upon by the parties.

2. The CHAIRMAN observed that both the suggestions made by the previous speaker at the 310th meeting could, if they were not already covered adequately in national legislations, be taken into account by States when adopting the Model Law.

3. Mr. TORNARITIS (Cyprus) expressed support for the Soviet Union proposal.

4. The CHAIRMAN noted that considerable enthusiasm had been displayed for that proposal. He suggested that the Soviet Union representative might be invited to assist the secretariat in incorporating it into the draft text.

5. *It was so agreed.*

Article 7. Definition and form of arbitration agreement

6. Mr. SEKHON (India) proposed a drafting change, to the effect that article 7 (1) should read "... all or any existing or future disputes between them ...".

7. Mr. GRIFFITH (Australia) said that paragraph (1) contained a definition which properly belonged in article 2.

8. The CHAIRMAN said that a suggestion to transfer the definition to article 2 had been made by Mexico in the discussion on that article (A/CN.9/SR.308, para. 10), but had not met with support.

9. Mr. STALEV (Observer for Bulgaria) asked whether a statement of claim and the reply to that claim submitted to an arbitral tribunal would constitute an exchange of letters under article 7 (2) and thus prove the parties' willingness to refer their dispute to arbitration. He proposed that the description of an agreement in writing given in article 7 (2) should be extended to cover an extract from the record of an arbitral tribunal. Such a provision might assist States in a liberal interpretation of the 1958 New York Convention in regard to the question of what constituted an agreement in writing.

10. The CHAIRMAN said that he did not think such an extract would constitute an agreement in writing unless it was signed by the parties.

11. Mr. HERRMANN (International Trade Law Branch) said that in his view a statement of claim and the reply to that claim would constitute an exchange of letters for the purposes of the article. He agreed that an extract from the record of an arbitral tribunal would be an agreement in writing if it was signed by the

parties. If the parties had made no specific arbitration agreement, either of them would be entitled to challenge the jurisdiction of the arbitral tribunal under article 16 (2), and failure to do so would indicate acceptance of the arbitral tribunal's authority.

12. Mrs. VILUS (Yugoslavia) reiterated her Government's written suggestion (A/CN.9/263/Add.1, p. 7, para. 7) that the Model Law should allow a party to validate an arbitration agreement by certain acts which were not in writing. If that suggestion was adopted, it would be necessary to include in article 35 a provision that a party must prove that the other party had accepted the authority of the arbitral tribunal.

13. The Government of Argentina had expressed the written view (A/CN.9/263, p. 20, para. 6) that the incorporation of an arbitration clause into a contract by reference, provided for in paragraph (2), should be made subject to the requirement that the party against whom the arbitration clause was invoked should be aware that it had been incorporated into the contract. That was especially relevant to contracts for the sale of commodities. Her delegation considered that the contract itself should inform the parties of the incorporation of the clause.

14. Mr. ILLESCAS ORTIZ (Spain) said that the Commission had two separate problems before it: the form of the arbitration agreement and the proof of its existence before the arbitral tribunal, and it was important not to confuse the two.

15. Mr. NEMOTO (Observer for the Asian-African Legal Consultative Committee) said that a written document was not sufficient proof of an act under some legal systems; in Japan, for instance, the document must bear an official seal. In his view, the matter was best left to national legislation.

16. Mr. BONELL (Italy) said that the Model Law could only provide general guidelines about what constituted an agreement in writing. He supported the United Kingdom's written proposal (A/CN.9/263, p. 5, para. 16) that the paragraph should use the formulation employed in article 17 of the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgements, as amended.

17. Mr. HOLTZMANN (United States of America) supported the Bulgarian proposal. It gave expression to the legal concept that certain conduct, in the present case participation in the proceedings, constituted evidence of agreement. He agreed with the view expressed by the Italian representative.

18. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that Norway had made a written proposal for paragraph (2) (A/CN.9/263, p. 19, para. 5); it might deal adequately with bills of lading, but a more general clause was needed. The best possibility seemed to be offered by article 17 of the 1968 Brussels Convention, as amended. It was important to establish that contracts effected by the parties in a manner acceptable in trade usage should constitute sufficient agreement in writing for the purpose of the paragraph (2). He urged the Commission to give serious consideration to that point and reflect it in the paragraph.

19. Mr. RUZICKA (Czechoslovakia) said he supported the Bulgarian proposal, which had practical merits.

20. Mr. HUNTER (Observer for the International Bar Association) said he fully agreed with the idea of extending the scope of what could constitute an arbitration agreement. He would nevertheless caution the Commission against going too far in that direction, because a problem might arise if an arbitration took place in a country which had adopted the Model Law and a party sought to enforce it under the 1958 New York Convention in a country which had not adopted the Law.

21. Mr. AYLING (United Kingdom) said that article 17 of the 1968 Brussels Convention, as amended, solved a problem common in international trade and, as far as his delegation was aware, was the only example of its kind. There might, of course, be better ways of solving it.

22. Mr. HOLTZMANN (United States of America) endorsed the comments made by the observer for the Chartered Institute of Arbitrators. He appreciated the words of caution voiced by the Observer for the International Bar Association about the problem which might arise with enforcement under the New York Convention. That problem might be less serious than it seemed, however, since the definition of an agreement in writing in that Convention (article II (2)) stated that it should "include", not that it should "be", the kinds of agreement there specified.

23. Mr. SCHUETZ (Austria) said that he shared the cautious approach recommended by the observer for the International Bar Association. The need for caution was in no way diminished by what the United States representative had said, particularly since the German version of article II (2) of the New York Convention had a very mandatory form. The adoption of the Bulgarian proposal would remove the need for written agreement, a requirement which protected the parties, and he could not accept it unless there was a corresponding requirement that the parties to an arbitration should be informed in advance by the arbitral tribunal that either party could insist on a written agreement if he wished.

24. Mr. BONELL (Italy), speaking on the Bulgarian proposal, said that there was no need for the Model Law to include a specific requirement of express agreement before or during the arbitration procedure, particularly if, once the procedure had started, the parties behaved in a way that unequivocally led to the conclusion that they agreed to arbitration. He thought the Model Law should perhaps lay down that principle explicitly. He did not think that the adoption of the Bulgarian proposal would create any difficulties in regard to the operation of the New York Convention.

25. With regard to the idea of using the wording of the 1968 Brussels Convention, as amended, he thought that consideration should be given to the possibility of establishing some uniformity among the various provisions concerning written-form requirements for jurisdiction and arbitration clauses. Article 17 of the revised version of the Brussels Convention was the most advanced and developed way of addressing a very complex problem.

26. Mr. ROEHRICH (France) said that he agreed with the remarks of the Austrian representative about the requirement of written form. It was true that, as far as international trade agreements were concerned, the 1968 Brussels Convention, as amended, dispensed with it in favour of the form sanctioned by trade practice, but it did so in connection with choice of jurisdiction. The Commission, however, was dealing with the

more important question of proof of the parties' agreement to withdraw their dispute from the jurisdiction of a particular State and to have it settled instead by a conventional procedure. The comment made by the United States representative with regard to the English text of article II (2) of the 1958 New York Convention did not apply to the French version, which had the same formulation as the German version. His delegation favoured a conservative approach, based on the need for written agreement, to the way in which the Model Law should deal with the question of proof of the existence of an arbitration agreement. In any case, it would prefer to see the Bulgarian proposal in writing. It could not support either the Norwegian or the Austrian written suggestions (A/CN.9/263, p. 19, para. 5 and p. 20, para. 8).

27. Mr. MOELLER (Observer for Finland) said that if the parties agreed to arbitration, the arbitrator would have no difficulty in obtaining their consent in writing. An extract of the record of the arbitral proceedings would not provide the same proof, and he would prefer the Model Law not to mention it.

28. Mr. STALEV (Observer for Bulgaria) said that since means of telecommunication were acceptable forms of proof, he saw no reason why records of the arbitral proceedings should not be acceptable as well.

29. Mr. HJERNER (Observer for the International Chamber of Commerce) supported the Bulgarian proposal but said that the Yugoslav proposal had merits as well. The basic philosophy of the two proposals was the same, namely that a party should not be able to object to the tribunal's jurisdiction if he had taken part in arbitral proceedings for a long time without objecting to them.

30. Mr. LEBEDEV (Union of Soviet Socialist Republics) also supported the Bulgarian proposal, which he found sound in ideas and substance.

31. The CHAIRMAN said that there appeared to be widespread support for the Bulgarian proposal. Unless he heard any objections, he would take it that the Commission approved it. He suggested that the Yugoslav proposal should be taken up under article 16.

32. *It was so agreed.*

33. Mr. MOELLER (Observer for Finland) said that if the notion of an agreement in writing was broadened, situations might arise in which an award could not be enforced under the New York Convention, but the notion should at least be widened to include a reference to bills of lading. It would not be a good idea to go as far as using the wording of article 17 of the 1968 Brussels Convention, as amended, since that would produce differing interpretations of the Model Law in different States.

34. Mr. MTANGO (United Republic of Tanzania) said that, while he appreciated the aim of expanding the notion of written agreement to include agreements in a form established by trade practice, the Commission ought to recognize that such practices were not necessarily established universally. It was doubtful in fact whether in many developing countries there would be sufficient awareness of such forms of trade practices which were established primarily in developed countries. The Model Law should be easy to adopt in most countries if its provisions included only those notions which were familiar and uncontested. Article 7 should be as clear as possible. He therefore favoured the existing, narrower formulation of the notion.

35. Mr. MAGNUSSON (Sweden) said that the notion of an agreement in writing should be broadened, but he too had doubts about that being done by the use of the wording from the Brussels Convention, which went too far. The Norwegian proposal might provide the best solution, and he suggested that a drafting group should consider it.

36. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that the interpretation of the provision in the last sentence of paragraph (2) was not touched on in the secretariat's commentary (A/CN.9/264). Was he correct in thinking that only a written form of contract, not signed by both parties, was sufficient for the application of that sentence? If that was the case, the sentence might justify the view that an arbitration clause in a bill of lading signed only by the carrier was binding on the receiver of the goods as well.

37. Mr. HERRMANN (International Trade Law Branch) said that, as far as he knew, the point had not been considered by the Working Group.

38. Mr. ROEHRICH (France) said that he thought the Working Group on International Contract Practices had intended the last sentence of paragraph (2) to refer only to model contracts and general conditions. The Norwegian proposal went too far; a reference in a bill of lading to an arbitration agreement should not constitute a valid arbitration agreement unless signed by both parties. If certainty as to the existence of an arbitration agreement was desired, there was no obstacle to concluding one. The present text was reasonable and should remain as it was.

39. Mr. TORNARITIS (Cyprus) said that there was unanimity on one point: there could be no arbitration without the agreement of the parties. But how was that agreement to appear? If in writing, would that mean that without the writing there was no agreement or that the purpose of the writing was simply to prove the agreement? Without departing from the idea of a writing, the Commission might provide that in certain cases a writing might be presumed to have existed, along the lines of the theory of the "lost grant" in English law. If at an arbitral tribunal the parties raised no objection to arbitration, it could be argued that they agreed to it by recourse. If the Working Group's intention had been that certain presumptions of the existence of the writing might be provided, his suggestion would meet the situation.

40. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) said that she shared the misgivings voiced about using the wording of the Brussels Convention. It used the words "or ought to have been aware", which were particularly dangerous for an instrument that was intended to have as wide an application as possible. The text should remain unchanged.

41. Mr. ILIESCAS ORTIZ (Spain) said that arbitral proceedings should be conducted on the basis of an agreement between the parties with regard to the settlement of their disputes. A unilateral statement stemming from a pre-existing contract should not be accepted as a basis for arbitration because of the awkward consequences that would arise if one

of the parties rejected the statement. His delegation favoured the text as already expanded.

42. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that the problem was not that of deciding what constituted an agreement or even an agreement in writing, but of determining whether the agreement was signed by both parties within the meaning of article 7. In present-day trade there were many contracts, even in writing, that were not signed by both parties. To draft the Model Law so narrowly as to exclude them from arbitration under the Model Law would be far too backward-looking. The representative of the Soviet Union had suggested that they might come under the third sentence of paragraph (2), but the fact remained that the second sentence called for signature by both parties. One way of meeting that requirement might be to expand the last sentence of paragraph (2) along the lines of the Norwegian suggestion.

43. The CHAIRMAN said that the Norwegian proposal implied that acceptance of a bill of lading amounted to an agreement on arbitration. That was not merely a question of drafting.

44. Mr. SAMI (Iraq) said that his delegation hesitated to see paragraph (2) amended unless answers could be found to several questions. A document signed by one party and indicating his willingness to resort to arbitration amounted to an offer that lay open for acceptance. Was the second party to indicate acceptance in writing, or could acceptance be tacit? And what legal interpretation would be put on his silence? An arbitration agreement implied the consent of the parties to settle disputes amicably. Such an agreement must be explicit and in writing.

45. Mr. RUZICKA (Czechoslovakia) said that article 7 should state the principle that an arbitral tribunal might settle disputes only on the basis of, and within the framework of, an arbitration agreement. That principle was implicit in article 34, which dealt with the consequences of applying the principle.

46. The CHAIRMAN suggested that the Commission should consider that principle in connection with arbitral procedure. It could subsequently decide to insert the principle in article 7 if it wished. He noted that the Commission had been unable to reach agreement on changing the draft text of the article, apart from accepting the Bulgarian proposal. He suggested that the representatives of Bulgaria and the secretariat should meet to redraft the second sentence of paragraph (2) and also incorporate the drafting suggestion made by India with regard to paragraph (1).

47. *It was so agreed.*

48. Mr. HJERNER (Observer of the International Chamber of Commerce) noted that, although no agreement had been reached on the Norwegian proposal, a substantial number of speakers had commented favourably on it.

The meeting rose at 12.25 p.m.

312th Meeting

Thursday, 6 June 1985, at 2 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 2.10 p.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 Add.1-2, A/CN.9/264)

Article 8. Arbitration agreement and substantive claim before court

Article 8 (1)

1. Mr. GRIFFITH (Australia) said the expression "in a matter" was too narrow and suggested that it should be replaced by "involving a matter", since although the matter itself might not be the subject of the arbitration agreement, it could be related to a matter that was.

2. Mr. HERRMANN (International Trade Law Branch) said that to use a phrase such as "relating to a matter" or "involving a matter" might introduce substantive differences, since a matter which was the subject of an arbitration agreement need not necessarily be the subject of a particular dispute. Legal systems differed widely in defining what was the subject-matter of a dispute. If it was only a question of drafting, he recommended that the Commission should retain the existing wording, which was that used in the 1958 New York Convention.

3. Mrs. RATIB (Egypt) found article 8 (1) acceptable. Her delegation agreed that the court should not of itself be empowered to refer the parties to arbitration and that a request for referral to arbitration outside the time-limit was inadmissible.

4. Mr. ABOUL-ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) found article 8 (1) acceptable. He proposed that article 8 (2) should be amended so as to empower the court to order the suspension of arbitration proceedings. He further proposed that the Commission should re-examine articles 8, 16, 34 and 36 in order to overcome the problem created by the fact that under those articles it was possible for a party to challenge the validity of the agreement repeatedly, while relying on the same reasoning.

5. The CHAIRMAN said that whether or not a court had the power to suspend arbitration proceedings depended on the national procedural law in force. Moreover, in certain procedural laws, a decision taken on the validity of an arbitration agreement would bind all courts of the same level in subsequent proceedings.

6. Sir Michael MUSTILL (United Kingdom) said that the answer just given by the Chairman provided a good illustration of the problems which his delegation had wished to raise in connection with article 5 and of the problem of repeated unmeritorious applications. Where local procedural law permitted a court to suspend its proceedings, would that not be an instance of intervention by the court?

7. The CHAIRMAN pointed out that article 8 (1) said that the court had to refer the parties to arbitration. It had been suggested that the court could either take action upon the merits or refer the parties to arbitration. The proposal had been made that the court should have a third possibility, i.e. that of referring the parties to arbitration while keeping its own proceedings open until a later stage. In his opinion, that was not

explicit in the text, and the question of whether court proceedings would theoretically remain open would depend on the provisions of the local procedural law.

8. Sir Michael MUSTILL (United Kingdom) said that the present discussion illustrated the problem of interpretation of the words "governed by this Law" in article 5. The question of what a court should or might do if the action in court was in relation to the subject of an arbitration agreement was governed by that law. He understood from the explanation by the secretariat that once a topic was found to be dealt with in the Model Law, the court could look only to the Model Law and not to local law. The court had no power to take steps not permitted in article 8.

9. The CHAIRMAN thought that that was too narrow a view of article 8. The court must accept an action and then decide whether the agreement was null and void; in that case, it would follow the normal court procedure. If it found that the agreement was valid, it would refer the parties to the arbitral tribunal. However, the details of court procedure could not be included in a uniform law since they were a matter of civil procedure in each State. In article 5, only the type of intervention was limited.

10. Mr. MOELLER (Observer for Finland) said that there was an inconsistency between articles 8 and 16 in the case where the arbitral tribunal had ruled but had made no award and there was an action before the court. In considering whether preference should be given to article 8, it was advisable to be consistent with article 6 (3) of the 1961 Geneva Convention.

11. Mr. HOLTZMANN (United States of America) said that the problem was in part alleviated by the definition of what was meant by "the beginning of arbitral proceedings" set out in article 21 of the Model Law.

12. The CHAIRMAN, noting that there were proposals for more than one draft of article 8 (1), suggested that the text should be left unaltered but that the report for the present session should state that the course of the judicial proceedings was not described there, so that it was quite possible for a decision to be taken to refer the parties to arbitration, while the case remained open pending a further possible application. If there was no objection, he would take it that the Commission agreed to that course.

13. *It was so agreed.*

Article 8 (2)

14. Mr. SEKHON (India) suggested the insertion of the words "unless a stay is granted by the court" in article 8 (2). That point would be regulated by local law, although he thought there were difficulties relating to the intervention by the court.

15. Mr. IJERNER (Observer for the International Chamber of Commerce) said that although the criticisms of article 8 (2) were understandable, the provision should be retained in the interests of the efficiency of the arbitral proceedings, regardless of actions by one party in a local or foreign court to delay or prevent them.

16. Mr. SEKHON (India) said he had raised the point because he felt that it should be made clear beyond doubt that the arbitral proceedings should continue regardless of any action in court unless a stay was granted by the court.

17. Mr. SZASZ (Hungary) felt that the text should state that the arbitral tribunal could make an award under the agreement, since under article 16 it had the power to decide on its own jurisdiction.

18. Mr. de HOYOS GUTIERREZ (Cuba) said that there was no reason to continue the proceedings if the arbitration agreement was not valid.

19. Mr. LEBEDEV (Union of Soviet Socialist Republics) could not agree that article 8 (1) implied a decision that questions concerning the court should not be touched upon. He suggested that article 8 (2) should be replaced by two provisions. The first would state that even where one party had already applied to the court, the other party could start arbitral proceedings. From the existing draft, it might be wrongly concluded that if arbitral proceedings had not been started prior to the application to the court, they could no longer be initiated while the matter was pending before the court. The second provision, following article 6, paragraph 3, of the 1961 European Convention, might state that if arbitral proceedings had been started before the filing of a court action, the court should stay a ruling on the arbitrator's jurisdiction until the award was made.

20. It was unrealistic to provide only for the possibility of continuing arbitral proceedings, since in most cases, arbitrators, knowing that their competence was being considered by the court, would prefer not to continue with the proceedings. Delay would be avoided if the arbitral proceedings were allowed to reach a conclusion. A dissatisfied party would still be able to apply to the court to have the award set aside under article 36.

21. Mr. RUZICKA (Czechoslovakia) proposed that the court procedure should be completed before continuing with the arbitral proceedings. The court decision would of course have to be final. However, the essential thing was to establish a clear preference as between the court and the arbitral tribunal, and his delegation could accept the opposite view, namely that the tribunal should have precedence, if that was the generally accepted view. The arbitral proceedings could then continue up to the point of the award.

22. Mr. HOLTZMANN (United States of America) believed in the principle that arbitration should proceed and not be stayed by the court. He supported the Hungarian proposal, which clarified the matter, and also favoured the USSR proposals.

23. Mr. STALEV (Observer for Bulgaria) strongly supported the USSR proposals, which would bring clarity and effectiveness to arbitral proceedings.

24. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) supported the USSR proposals. He drew attention to the view that the issue before the court, as dealt with in article 8 (1), was not the "issue of its jurisdiction", so that article 8 (2) should be rephrased accordingly. It was not the matter of jurisdiction that was before the court. The agreement might be valid, but the tribunal not competent because the conditions set in the agreement were not fulfilled. Article 8 (2) was ambiguous and it was therefore important to seek another form of words.

25. Mr. HOLTZMANN (United States of America) said that, in principle, arbitration should not be stayed by court

proceedings. The reasons had been well stated by the observer for the International Chamber of Commerce and those who had agreed with him. His delegation, therefore, supported the Hungarian proposal as clarifying and implementing the principle better than the existing text. It also found the USSR proposals attractive, for the same reason.

26. Mr. STALEV (Observer for Bulgaria) was in favour of a closer alignment with the 1961 European Convention on International Commercial Arbitration and accordingly supported the USSR proposals.

27. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) also supported the USSR proposals. The point that article 8 (2) was ambiguously worded had been raised by Cyprus in its written comments, and the question of language was also referred to in those of the Soviet Union (A/CN.9/263, p. 21, para. 6). A distinction must be drawn between the two different problems and, while paragraph 1 of article 8 was clear, paragraph 2 was not.

28. Mrs. RATIB (Egypt) said that it would be useful to give the courts power to order the suspension of the arbitral proceedings when they considered that the most likely outcome would be that the agreement was null and void. That would save both time and expense. Her delegation therefore suggested restoring the phrase "unless the court orders a stay of the arbitral proceedings", which had been in the original text but had been deleted by the Working Group.

29. Sir Michael MUSTILL (United Kingdom) thought that attention was perhaps being drawn away from the nature of the situation with which article 8 (2) was concerned, as expressed in the title of the article. Article 16 of the draft Law was concerned with the situation in which a court became involved because one of the parties to an arbitration challenged the arbitral tribunal's jurisdiction. The situation in article 8 was quite different: it concerned an attempt to have the substantive dispute itself decided by a court. If both of the Soviet Union's suggestions were adopted, the result would be that the same dispute would go forward in two different places: the court would retain the matter if it concluded that the arbitral tribunal had no jurisdiction and would make a judgement, but the arbitral proceedings would also go forward. It was surely not desirable to have a double decision on the same substantive matter. He favoured the philosophy suggested by the Egyptian representative, which was implicit in the existing text in any case. He therefore urged that the text should be retained in its existing form.

30. Mr. LEBEDEV (Union of Soviet Socialist Republics) explained that the aim of his delegation's proposals was precisely to avoid the possibility of two substantive decisions. The aim was that, where one of the parties had gone to the court with a substantive claim, the court should refrain from making a ruling on the arbitrator's jurisdiction until after the arbitral award, thus avoiding the possibility of two substantive decisions on the same matter.

31. The CHAIRMAN said that if the Commission felt it inconsistent to confine article 8 (2) to arbitral proceedings that were already under way, the wording could be changed to "are about to commence or have already commenced". The second problem was that of how far the arbitral tribunal should be able to continue its proceedings. The USSR proposal was closer to the 1961 Convention, which said that if the proceedings had already been initiated before any resort to a court, the court must stay its ruling on the arbitrators' jurisdiction until the arbitral award was made. In the other interpretation, not only would the parties be allowed to go to court but the arbitral

proceedings could continue even if the court found that the arbitration agreement was non-existent or null and void.

32. Sir Michael MUSTILL (United Kingdom) said that the question, as he saw it, was whether to protect the claimant against the risk of delay through an objection of no merit, or the defendant against a waste of time and money in being brought before an arbitral tribunal which was ultimately found not to have existed in any real sense. Both parties lost if the dispute had to be fought twice. His delegation felt that the court should be able to decide from the beginning whether the arbitration should go ahead. If it found that it should, the court would relinquish jurisdiction. If, however, it decided that the agreement was void, it would continue its consideration of the case.

33. The CHAIRMAN pointed out that the article said that the arbitral proceedings could continue, not that they must continue. However, difficult questions of international competence were also involved: for example, the court's decision might not be recognized in the other country concerned. If the court said that the agreement was null and void, the decision might be binding only in the territory of "this State". The defendant might consider that, even with a court decision, if the arbitral proceedings continued as far as an award, it might be possible to enforce it, if not in the country where the court's decision was binding, perhaps in another country.

34. Mr. SZASZ (Hungary) said the question was that of which party's interests should be protected. He felt that the wisest course would be not to give room to purely dilatory tactics and to allow the claimant to decide whether it was worthwhile going on with the arbitral proceedings.

35. Mr. HOLTZMANN (United States of America) felt strongly that there should be one set of proceedings at a time, and that it should be arbitration proceedings. It was not a question of favouring either the claimant or the defendant but of favouring the arbitration process. The question of the validity of the arbitration agreement could be decided by the arbitrators themselves as a preliminary question, and the presumption was that they would do so in appropriate cases.

36. Mr. MTANGO (United Republic of Tanzania) thought that the Model Law should make sure as far as possible that the parties were subjected to only one set of proceedings. He therefore supported the United Kingdom proposal to leave the text as it was.

37. Mr. SEKHON (India) said that the impression that had been given that the provision was founded on the 1961 European Convention was incorrect. He read out the text of article 6 (3) of that Convention, stressing the final phrase "unless they have good and substantial reasons to the contrary". That was not exactly what was being said in article 8 (2). He noted that some of the arguments that had been put forward assumed that the courts would not act objectively, impartially and fairly; in his judgement, that was a wrong assumption.

38. The CHAIRMAN said that most of the delegations involved in the preparation of the 1961 Convention had thought that the phrase just quoted seriously weakened it.

39. Mr. LEBEDEV (Union of Soviet Socialist Republics) felt that article 6 of the 1961 European Convention embodied a very valuable compromise and perhaps article 8 (2) ought to be drafted in exactly the same way. As for the contention that his delegation's proposal would not prevent the parties from going to court after arbitration proceedings had started, he

pointed out that one of the parties might need to go to court to suspend the running of the prescription period in order to protect his rights. The question was not one of protecting the interests of either the plaintiff or the defendant but of protecting the institution of arbitration itself, as the United States representative had pointed out.

40. The CHAIRMAN said that no clear majority seemed to have emerged in favour of changing the text. The discussion closely paralleled that in the Working Group, the outcome of which had been the existing article 8. In order to avoid further lengthy discussion, he proposed that the existing text of article 8 should be retained.

41. *It was so decided.*

Article 9. Arbitration agreement and interim measures by court

42. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that, at first sight, article 9 was rather enigmatical. Paragraph 1 of the secretariat's analytical commentary on the article (A/CN.9/264, p. 25) sought to explain that the fact that the parties had entered into an arbitration agreement did not mean that they had renounced their right to go to court for interim measures. If that was the whole content of the article, it was harmless and possibly even unnecessary. Supposing, however, that the parties had agreed between themselves in their arbitration agreement that they would not apply to a court for interim measures, the question arose whether such an agreement was rendered invalid by article 9. A rule precluding such application to a court was contained in the rules of the London Court of International Arbitration, and that provision had been found valuable and acceptable. If there was no intention to make agreements of that kind invalid, some clarification was necessary on the lines of "It is not incompatible with a submission of a dispute to arbitration for a party ...".

43. Mr. HERRMANN (International Trade Law Branch) said that the Working Group's intention in article 9 had been to express that the mere existence of an agreement to arbitrate should not prevent a party from requesting interim measures of protection from a court, or prevent a court from granting such measures. The article had been felt necessary because there had been instances in judicial practice in which the existence of an agreement to arbitrate had resulted in the full exclusion of court jurisdiction. There was no intent to take away the effect of agreements to refrain from requesting interim measures from a court.

44. Mr. HOELLERING (United States of America) said his delegation noted that the scope of interim measures which a court might grant was wide and included pre-arbitration attachments. He suggested that there should also be a clear understanding that in appropriate circumstances protection would extend to trade secrets and other proprietary information, particularly in respect of articles 26 and 27 relating to the production of documents, goods or other property for the inspection of an expert appointed by the arbitral tribunal or sought by a court. He thought that such a clarification would be useful in view of the increasingly complex nature of international commercial transactions giving rise to arbitral disputes; those transactions included nowadays complicated long-term agreements on such matters as construction of industrial works or the transfer of technology.

45. Mr. LAVINA (Philippines) said that article 9 was intended to cover more than just the question of the

favourable response of a court to a party's request for interim measures. He therefore suggested that the final phrase, "to grant such a measure", should be replaced by "to act on the request".

46. Mr. ROEHRICH (France) said that there had been a proposal for a substantive amendment to article 9 which would tend to support an interpretation that the national courts were bound to respect a prior agreement by the parties not to apply to the courts for interim measures. His delegation was satisfied with the present text of article 9 precisely because it left that issue open. Such a course was also in the interests of the parties themselves, who could not foresee every eventuality in advance. He suggested that the original text should be maintained.

47. Mr. AYLING (United Kingdom) suggested that the text could perhaps be improved by replacing the words "the arbitration agreement" in the first line by "an arbitration agreement".

48. Mr. ROEHRICH (France) said he had no objection to that amendment.

49. Mr. HJERNER (Observer for the International Chamber of Commerce) observed that there was some difficulty in the relationship between articles 5, 9 and 18. If a party asked for interim measures first from the arbitral tribunal and subsequently from the court, that might well result in conflicting interim measures being ordered.

50. The CHAIRMAN said that a Model Law could not go into details of that nature. If there were no further comments, he would take it that article 9 would be retained, on the understanding that the drafting suggestion by the United Kingdom would be incorporated.

51. *It was so agreed.*

Chapter III. Composition of the arbitral tribunal

Article 10. Number of arbitrators

52. Mr. SCHUMACHER (Federal Republic of Germany) said that his delegation had submitted a written proposal (A/CN.9/263, p. 22) that chapter III should mention the principle that the composition of the arbitral tribunal must guarantee an impartial decision; that seemed to be the most important guideline for arbitration. His delegation was withdrawing that proposal because it would cause problems with the interpretation of articles 12 and 13 from which it followed that each arbitrator, even nominated by one party, must be impartial and independent. Accordingly, it followed that the tribunal itself must be impartial.

Article 11. Appointment of arbitrators

Article 11 (1)

53. The CHAIRMAN noted that there were no comments on article 11 (1).

Article 11 (2)

54. Mr. HJERNER (Observer for the International Chamber of Commerce) asked whether it would not be desirable to state expressly in article 11 (2) that all arbitrators should be impartial and independent, in view of the vast differences in practice.

55. The CHAIRMAN pointed out that lack of impartiality or independence were grounds for challenge and for setting aside the award.

56. Mr. SEKHON (India) stated that it would be better to start the paragraph with the phrase "Subject to the provisions ... of this article".

Article 11 (3)

57. Mr. LEBEDEV (Union of Soviet Socialist Republics) drew attention to the written amendment which his delegation had submitted to article 11 (3) (a) (A/CN.9/263, p. 23), namely to replace the words "within thirty days of having been requested to do so by the other party" by the words "within thirty days of receipt of such request from the other party".

58. The CHAIRMAN said that the secretariat would take the appropriate action.

59. Mr. de HOYOS GUTIERREZ (Cuba) suggested that for the purposes of speeding up proceedings, it would be desirable to insert a time-limit also in article 11 (3) (b), with respect to the appointment of a sole arbitrator.

60. Mr. HERRMANN (International Trade Law Branch) said that the Working Group had endeavoured to avoid fixing time periods as far as possible since it was difficult to select a period which was appropriate to cover the many different cases. Furthermore, the situation in article 11 (3) (b) was not precisely the same as that in article 11 (3) (a). It resulted from a failure of the parties to agree, of which the best evidence was the request of one of them to the court to appoint the arbitrator.

61. Mr. de HOYOS GUTIERREZ (Cuba) withdrew his proposal.

62. The CHAIRMAN said he assumed that in cases where the place of arbitration had been determined, the court referred to in paragraphs 3 (a) and (b) would be the appropriate national court of the country concerned.

63. *It was so decided.*

64. Mr. HOLTZMANN (United States of America) said that the Commission must take a decision on which court should be deemed the competent court under article 11 (3) when the parties had not yet agreed upon a place of arbitration. The choice lay between the national courts in the countries where either the defendant or the claimant had his place of business. He favoured that of the claimant since the defendant had failed to appoint an arbitrator under article 11 (3) (a).

65. The CHAIRMAN pointed out that under the 1961 European Convention, the country of the defendant had been selected. It would consequently be hard for States which were parties to the European Convention to agree to any different arrangement. Perhaps, if the authority in the defendant's country failed to appoint an arbitrator, the duty might pass to the authority in the claimant's country.

66. The CHAIRMAN suggested that the secretariat, in consultation with the United States representative, might propose suitable wording. The issue appeared to be settled in respect of article 11 (3) (a). As to article 11 (3) (b), in cases where no place of arbitration had been selected, the matter was perhaps rather more difficult and it had in fact been the subject of a complete annex in the European Convention.

67. Mr. HERRMANN (International Trade Law Branch) pointed out that the situation, which might be covered by the decision just adopted, namely that it would be the authority of the defendant's country, would apply only until the place of arbitration was agreed or the parties exercised their freedom to choose another procedural law. At that stage, the problem would be solved and it was therefore questionable whether there was any need to make a special provision in the Model Law. The parties were not left in a vacuum, since there existed arbitration laws which would give assistance similar to that provided in the Model Law itself.

68. Mr. EYZAGUIRRE (Observer for the Inter-American Bar Association) said that the case envisaged was a very remote possibility for which there was adequate provision in institutional arbitration arrangements. It was not a matter of great importance whether the decision was taken by the national court of the claimant or that of the defendant or by some third party.

69. Mr. HOLTZMANN (United States of America) pointed out that under the UNCITRAL Arbitration Rules application might be made to the Secretary-General of the Permanent Court of Arbitration at the Hague to designate an appointing authority.

70. Mr. STALEV (Observer for Bulgaria) thought that, in view of the rarity of the case, it would be reasonable to accept the national court of the country in which the defendant had his place of business, i.e. the same solution as in article 11 (3) (a).

71. Mr. HERRMANN (International Trade Law Branch) observed that the Model Law could state only whether, in the case of States which had adopted the Model Law, the court specified under article 6 should perform that function or not. A provision might be adopted along the following lines: "irrespective of whether this law in general applies, before the place of arbitration or, if permitted, the procedural law is chosen, the court specified under article 6 may render assistance under article 11, provided that the defendant has his place of business in this territory". With such a provision, it would be difficult for the court to refuse to act.

72. The CHAIRMAN said that the court might have doubts as to the validity of the arbitration agreement.

73. Mr. STALEV (Observer for Bulgaria) said that the court might take no action for a considerable time.

74. The CHAIRMAN, noting that such cases were very rare and that the elaborate arrangements in the 1961 European Convention had never been applied in practice, proposed that the same rule should be adopted for paragraphs 3 (a) and (b). Where no place of arbitration had been agreed, the appointment of the sole arbitrator should rest with the national court of the territory in which the defendant had his place of business, or if that court refused to act, with the national court of the territory in which the claimant had his place of business.

75. *It was so decided.*

Article 11 (4)

76. Mr. HOLTZMANN (United States of America) observed there was another reference in article 11 (4) to the court specified in article 6.

77. The CHAIRMAN suggested that the same rules should be adopted as in article 11 (3).

78. Mr. STROHBACH (German Democratic Republic) observed that article 11 (4) (c) referred to "an appointing authority". It might perhaps be useful to have a definition of that term in article 2.

79. The CHAIRMAN observed that the definitions in article 2 covered terms which were used in more than one place. If the term "appointing authority" appeared only in article 11, it would be better to have it defined in the rule itself.

80. Mr. STROHBACH (German Democratic Republic) said he would check whether the term was used elsewhere.

The meeting rose at 5.05 p.m.

313th Meeting

Friday, 7 June 1985 at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 9.35 a.m.

International commercial arbitration (continued) (A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264)

Article 11. Appointment of arbitrators (continued)

Article 11 (4) (continued)

1. Mr. ROGERS (Australia) said that during the discussion of article 2 (e), his delegation had referred to the possibility of substituted service in cases in which it was known that the addressee was not at his last known business address or habitual residence. The problem was that the provision on receipt of communications in article 2 (e) was so carefully worded that a court might think the provision barred it from ordering substituted service. He proposed that the Commission should insert a provision in article 11 to make it clear that such an effect was not intended.

2. The CHAIRMAN said that in his view service under article 2 (e) was confined to service effected in the course of arbitral proceedings, including notification of choice of arbitrators and service of the award, and excluded service ordered by a court. It might be better to make that point clear in article 2 (e).

3. Mr. HOLTZMANN (United States of America) supported the Chairman's suggestion.

4. Mr. ROGERS (Australia) accepted the suggestion.

Article 12. Grounds for challenge

Article 12 (1)

5. Mr. KADI (Algeria) said that although the Working Group on International Contract Practices had already dealt with the

point, his delegation still felt that paragraph (1) should make a reference to the qualifications of a possible arbitrator. He proposed that the beginning of the paragraph should read "When a person is approached in connection with his qualifications for possible appointment ...".

6. Mr. SAWADA (Japan) proposed that the beginning of paragraph (1) should read "A person approached in connection with his possible appointment as an arbitrator shall disclose ...".

7. Mr. HOLTZMANN (United States of America) said that he preferred the present wording because it indicated the need for promptness.

8. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that articles 12-15 were of particular interest to arbitrators. He thought the Working Group had done an excellent job on what were essentially mechanical provisions.

Article 12 (2)

9. Mrs. VILUS (Yugoslavia) said that the intention of the word "only" in the first sentence of paragraph (2) seemed to be to confine challenges to the issues of impartiality and independence. That might prove too restrictive in some instances. It might be useful to expand the paragraph to allow challenges on other grounds.

10. Mr. SZASZ (Hungary) said that challenges should be restricted, and the word "only" helped to make that clear. His delegation nevertheless supported the written suggestion from the United States (A/CN.9/263, p. 24 (article 12), para. 3) for the addition to the sentence of the words "or on such additional grounds as the parties may agree".

11. Mr. SEKHON (India) said that he was not happy with the words "an arbitrator may be challenged" at the beginning of paragraph (2). The challenge would be to the arbitrator's appointment, not his person. He suggested that the sentence be redrafted to take account of that. While he felt that the word "only" might be deleted, the inclusion in the sentence of a third factor, as suggested by the United States, was a different matter.

12. Mr. de HOYOS GUTIERREZ (Cuba) endorsed the comments made by the representative of Hungary.

13. Mr. MTANGO (United Republic of Tanzania) said that he would like the word "only" to be deleted. It was true that in most cases challenges would address the question of impartiality or independence, but other factors might arise; in certain circumstances, for example, without the arbitrator's integrity being called into question, his nationality might be thought a sound ground for challenge in view of certain policies followed by his Government.

14. Mr. HOLTZMANN (United States of America) said that the paragraph, like the corresponding paragraph in the UNCITRAL Arbitration Rules, covered the point made by the Tanzanian representative by using the words "justifiable doubts". It was therefore unnecessary to delete the word "only". He agreed that such doubts might in exceptional cases arise because of a person's nationality. He thought that the implication of the last sentence of paragraph 4 of the secretariat's commentary on the article (A/CN.9/264, p. 31) was too broad to represent the view of the Commission, since the general reference, which was to impartiality or

independence, did not cover all the grounds for challenge mentioned in national legislation.

15. Mrs. VILUS (Yugoslavia) pointed out that the arbitration rules of the International Chamber of Commerce contained a provision for challenging an arbitrator if he delayed the proceedings or did not perform his duties in accordance with those rules. The word "only" made the draft text more restrictive than the ICC rules.

16. The CHAIRMAN said that the point made by the previous speaker seemed to be covered in article 14.

17. Mr. TANG Houzhi (China) said that he appreciated the point made by the Tanzanian representative but had no strong feelings about the deletion or retention of the word "only". He did not feel that the addition proposed by the United States was necessary.

18. Mr. MTANGO (United Republic of Tanzania) said that the parties might disagree as to whether certain doubts were justifiable. If so, who would decide the point? He supported the addition to the text suggested by the United States.

19. The CHAIRMAN said that article 11 (1) would permit a challenge on the ground of nationality if that was in accordance with the wishes of the parties. He too felt that an arbitrator's nationality might imply justifiable doubts about his impartiality or independence. The reason why the draft text contained the provision in article 11 (1) was of course that under the laws of some countries foreigners could not be appointed as arbitrators.

20. Sir Michael MUSTILL (United Kingdom) said that if an arbitrator's nationality raised justifiable doubts about his impartiality or independence, he could be challenged under article 12 (2). That situation would not alter if the word "only" was deleted.

21. Mr. HOLTZMANN (United States of America) agreed. He did not think the deletion of the word "only" would make any difference. However, the corresponding paragraph of the UNCITRAL Arbitration Rules did not use the word "only", and it might be considered that the Commission follow that example.

22. Mr. LAVINA (Philippines) said that he too favoured the idea of deleting the word "only". He supported the drafting suggestion made by the representative of India.

23. Mr. EYZAGUIRRE (Observer for the Inter-American Bar Association) said that the word "only" should be retained, since it seemed that its deletion would give rise to differing interpretations by different delegations. He supported the written proposal of the United States Government.

24. Mr. KADI (Algeria) said that if the Commission with its expert knowledge could not agree on the interpretation of the article, Governments would find it difficult to understand it clearly.

25. Mr. MOELLER (Observer for Finland) endorsed the remarks made by the Hungarian representative and by the observer for the Inter-American Bar Association. He supported the United States written proposal.

26. Mr. MTANGO (United Republic of Tanzania) pointed out that the Commission had decided at its twelfth session that the Model Law should take due account of the

UNCITRAL Arbitration Rules, but the corresponding paragraph of those Rules did not contain the word "only".

27. Mr. HERRMANN (International Trade Law Branch) said that the Working Group had included the word "only" with the intention of clarifying the meaning of the article. It was important to bear in mind the difference between a model law intended for adoption as national legislation and a set of optional rules which might become part of a contract. He thought the real issue was not the retention or deletion of the word "only" but whether to extend the scope of the article.

28. Mr. de HOYOS GUTIERREZ (Cuba) said that the deletion of the word "only" would make no difference to the meaning. The addition proposed by the United States Government would make the article less restrictive.

29. Mr. SEKHON (India) said that the concept of justifiable doubts as to an arbitrator's impartiality or independence did not seem a restrictive one at all.

30. Mrs. RATIB (Egypt) said that article 11 (5) stated that a court appointing an arbitrator should consider any qualifications agreed upon by the parties as well as the likelihood of the impartiality and independence of the arbitrator. Perhaps a similar formulation should be employed in article 12 (2).

31. Mr. ROEHRICH (France) said that impartiality and independence were already wide-ranging concepts. If the United States written proposal was adopted, the word "only" might be retained.

32. Mr. SZASZ (Hungary) said that in his country, the sentence would be interpreted restrictively even without the word "only".

33. Mr. ILLESCAS ORTIZ (Spain) said that the word "only" should be retained, since it made the restrictive meaning of the article clear. In most cases, a party would specify the reason for his doubts about the arbitrator's impartiality or independence when challenging him. National legislators would be free to specify other grounds than those mentioned in article 12 (2) when they adopted the Model Law. However, his delegation would not object to the addition proposed by the United States.

34. Sir Michael MUSTILL (United Kingdom) said that the Commission's difficulty with article 12 (2) stemmed from the unresolved uncertainty about the meaning of the words "matters governed by this Law" in article 5. If it was true that a challenge on a ground agreed between the parties did not constitute a challenge on a ground contained in the Model Law, article 5 meant nothing and served only to emphasize the lack of clarity about the Model Law, which permeated its entire text.

35. Mr. ABOUL-ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) suggested that a provision should be added to article 12 (2) to the effect that the parties might agree on other grounds for a challenge.

36. Mr. LAVINA (Philippines) said that it would be helpful to have some clear indication whether the Commission wished to delete the word "only". Accordingly, he made a formal proposal for the Commission to have an "indicative vote" on the issue. That method was not new and had been used by the Commission in the past.

37. Mr. MTANGO (United Republic of Tanzania) observed that support had been expressed for the idea of deleting the word.

38. The CHAIRMAN said he felt it was the view of the majority of the Commission that the word "only" should be retained. The report might explain that the intention of article 12 (2) was the same as that of article 10 (1) of the UNCITRAL Arbitration Rules. The United States written proposal appeared to command considerable support. It should perhaps be made clear, on incorporating it into the draft text, that in exceptional cases the concept of "justifiable doubts" might extend to the nationality of an arbitrator. He suggested that the representatives of the United States, India and Algeria, and any others interested, should meet with the secretariat in order to decide the best way of incorporating the United States proposal into the article.

39. *It was so agreed.*

Article 13. Challenge procedure

Article 13 (1)

40. Mr. STALEV (Observer for Bulgaria) said that, as the secretariat had indicated in its commentary (A/CN.9/264, p. 32, para. 4, second sentence), article 13 did not adequately cover the problem of a sole arbitrator who was challenged and refused to resign. He suggested that words on the following lines might be inserted in paragraph (3) after the words "rejecting the challenge": "or of a sole arbitrator's refusal to withdraw".

41. Mr. HOLTZMANN (United States of America) drew attention to his country's written proposal for paragraph (1), reproduced in document A/CN.9/263 (p. 25, para. 8), to the effect that a decision reached under a challenge procedure agreed by the parties should be final.

42. The CHAIRMAN asked whether that would mean that the decision could not be reversed by a court.

43. Mr. HOLTZMANN (United States of America) said that while there might occasionally be grounds for appealing such a decision, by and large the presumption should be that it was final and binding on the parties.

44. Mr. ROEHRICH (France) said that the United States proposal seemed to mean that there would be a uniform rule stating the consequences of a choice of challenge procedure by the parties. If so, he would have some hesitation in accepting it, because it was impossible to predict what challenge procedure they might choose. If the parties were to be allowed such freedom of choice under paragraph (1), a view which he accepted, why should not the question of possible appeals against a challenge decision be left open? He would prefer to keep paragraph (1) as it stood.

45. Mr. MOELLER (Observer for Finland) shared the doubts of the representative of France. His view was that the Model Law should exclude recourse to a court during arbitral proceedings and give the parties the right to challenge the award afterwards, but the Working Group had rejected that idea. He could nevertheless accept the text as it stood. It did not create a problem. For example, if the parties had agreed that challenges should be decided by an institution and the agreed institution rejected a challenge, the unsuccessful party would be disinclined to go to court because he would know that by then his chances of success were slight. Thus the existing text should not have the effect of delaying arbitrations.

46. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that his delegation's written proposal, reproduced in A/CN.9/263 (p. 26, para. 10), to delete or at least considerably limit paragraph (3) was directly related to paragraph (1). Regardless of what happened to paragraph (3), however, he considered that the United States proposal was justified. If parties had agreed on an institutional procedure for challenging an arbitrator, the procedure should be applied without recourse to the court. Article 34 appeared to allow an appeal against an arbitral award on the ground that an arbitrator was not impartial or independent. If so, why have a judicial procedure for that circumstance in article 13 as well? His view was borne out by the comments of the International Chamber of Commerce, reproduced in A/CN.9/263/Add.1 (p. 10, para. 1).

47. Mr. HOLTZMANN (United States of America) agreed with the Soviet Union representative that court intervention during arbitral proceedings should be avoided.

48. Sir Michael MUSTILL (United Kingdom) said that his Government did not share that view, for reasons which would be clear from its interventions on other articles.

49. The CHAIRMAN suggested that the question should be discussed under paragraph (3).

50. *It was so agreed.*

Article 13 (2)

51. Mr. STROHBACH (German Democratic Republic) referred to the statement made by the Observer for Bulgaria. While the second sentence of paragraph (2) contained a ruling

on how to proceed if one of a panel of arbitrators was challenged, the question remained how to deal with a challenge where there was only one arbitrator. In his opinion the simplest way would be to amend paragraph (2) to provide that a sole arbitrator who was challenged had the possibility of withdrawing, and that if he did not, his mandate would be terminated.

52. The CHAIRMAN pointed out that such a provision could give rise to a never-ending series of challenges.

53. Mr. HERRMANN (International Trade Law Branch) said the secretariat's view was that a sole arbitrator who was challenged and did not resign implicitly made the decision contemplated in paragraph (2). The paragraph therefore seemed comprehensive and simple in operation.

54. Mr. MAGNUSSON (Sweden) said that it might be inadvisable to allow an arbitrator who had been challenged during the proceedings to withdraw voluntarily, since if he did so late in the proceedings the result might be considerable expense and lengthy delay. It might be better to provide that the arbitral tribunal should decide whether a challenged arbitrator should respond to the challenge immediately or at the end of the proceedings.

55. Mr. SCHUMACHER (Federal Republic of Germany) said that where one of a panel of arbitrators had been challenged, it was best that he should not take part in the decision on the challenge. His country would have problems in implementing the rule in paragraph (2) because its national law embodied that principle.

The meeting rose at 12.30 p.m.

314th Meeting

Friday, 7 June 1985, at 2 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 2.05 p.m.

International commercial arbitration (continued)

(A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264)

Article 13. Challenge procedure (continued)

1. The CHAIRMAN recalled that article 13 was based upon a compromise between two different approaches to the question of challenges. One was that all decisions of the arbitral tribunal on a challenge to one of its members could be the subject of immediate application to the court. Arbitration proceedings would then be suspended until the challenge was either sustained, when the composition of the tribunal would be changed before it could proceed, or the challenge was rejected, when the original tribunal would continue its work. The second system left the decision on a challenge to the arbitral tribunal itself, but a rejected challenge could constitute grounds for contesting the final award. Article 13 embodied a compromise procedure whereby the final decision on the challenge rested with the court but the arbitral tribunal could continue its proceedings pending that decision.

2. Mrs. RATIB (Egypt) proposed that the concluding phrase of article 13 (3) should be amended to read "... pending such a decision, the arbitral tribunal, including the challenged arbitrator, may continue the arbitral proceedings, unless the

court orders their suspension". It would be preferable to give the court power to order the suspension of arbitral proceedings when it was made aware of reasons which might justify such a measure.

3. Mr. SEKHON (India) endorsed the Egyptian proposal. If arbitral proceedings continued pending a decision by the court and the latter later upheld the challenge, a good deal of unnecessary expense and delay would be incurred. The period of 15 days set in article 13 (2) and (3) was perhaps too short for cases of international commercial arbitration. He would suggest a period of 30 days unless the provisions of article 11 (1) of the UNCITRAL Arbitration Rules were scrupulously observed. Finally, in the fourth line of the English text of article 13 (2), the word "the" before "later" appeared to be redundant.

4. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that his delegation's proposal in respect of article 13 (3) was the most far-reaching of the various comments by Governments on article 13 (A/CN.9/263, p. 26, para. 10). The present text did not in fact constitute a compromise when compared to the legislation of countries such as his own which did not envisage the possibility of challenging an arbitrator before the court until the award had been made. The Soviet delegation's proposal was to delete paragraph 3

altogether from article 13, leaving paragraph 1 to apply if the parties agreed upon a challenge procedure and paragraph 2 to apply if they had not so agreed. It was clear, however, that paragraph 2 could apply only when there was a minimum of three arbitrators and the challenge affected only one of them. The representative of the German Democratic Republic had also rightly pointed out that it could not apply in the case of a sole arbitrator. His own alternative proposal would be to retain paragraph 3 but to restrict it to those cases where the challenge procedure had not been previously agreed by the parties and where the challenge affected a sole arbitrator or more than one arbitrator out of a panel of three.

5. Mr. STALEV (Observer for Bulgaria) said that a possible compromise would be to agree on full autonomy of the parties as far as the procedure for challenge was concerned by deleting from article 13 (1) the phrase "subject to the provisions of paragraph (3) of this article". In practice that would mean that in a case of institutional arbitration there could be no resort to the court if the institutional rules precluded it. As far as *ad hoc* arbitration was concerned, his delegation was ready to accept the procedure set out in article 13 (2) and (3). He suggested that the problem of the sole arbitrator should be considered later.

6. Mr. MTANGO (United Republic of Tanzania) said he preferred the Working Group's compromise, which took into account the fact that various legal systems adopted different attitudes towards court intervention. It was advisable to adopt an arrangement which would facilitate the adoption of the Model Law by all countries. Where intervention by the court was not the practice in national legislation, there was no reason to introduce it.

7. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) suggested a drafting amendment to insert in the second line of article 13 (2) the words "of notification" after the words "within fifteen days" and before the words "of the constitution". The United States proposal was acceptable and, as he understood it, article 13 (2) would apply to all cases except where there was a challenge to a sole arbitrator or to a majority of the arbitrators. He did not agree with the proposal of the representative of the German Democratic Republic that if a sole arbitrator refused to withdraw, he should be made to do so.

8. Mr. ABOUL-ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) endorsed the amendment proposed by the Egyptian representative.

9. Mr. AYLING (United Kingdom) supported the Working Group's compromise, for the reasons which were set out in the secretarial commentary on article 13 (A/CN.9/264, pp. 32 and 33). If the question was reopened, he would be inclined to support the Egyptian amendment.

10. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) said that the present wording of article 13 (3) left it to the discretion of the arbitral tribunal whether or not to continue its proceedings. It was not far from the Egyptian proposal, which was a useful one and which she accordingly supported.

11. Mr. GRIFFITH (Australia) said his position was the same as that of the United Kingdom representative.

12. The CHAIRMAN said that the proposal to delete paragraph 3 altogether had received little or no support. As for the two other proposals, they might perhaps be combined into a single amendment to the effect that the parties could

exclude a resort to the court but that when a challenge was brought before the court, the latter could stop the arbitration proceedings. He wondered whether the Commission might consider that a more acceptable compromise than the present article 13.

13. Mr. HOLTZMANN (United States of America) said the the Chairman's suggestion might be too complex.

14. Mrs. RATIB (Egypt) accepted the Chairman's suggestion.

15. Mr. ROEHRICH (France) asked whether it was not possible to keep the present text. His delegation wished to avoid a situation where national courts issued injunctions during arbitration proceedings. Their role should be the more general one of the setting aside of awards, the recognition or enforcement of foreign awards and the provision of assistance, when needed, with the composition of arbitration tribunals. Furthermore, he had doubts as to what sanctions could be envisaged if courts were given positive powers to order the suspension of arbitration proceedings. Article 13 (3), with the reservation in article 13 (1), wisely left the arbitral tribunal the option whether or not to continue its proceedings.

16. The CHAIRMAN said that the Egyptian amendment might put the courts in a difficult position. If a judge made an interim order to suspend the arbitration proceedings, would he not be inclined to uphold the challenge in his final decision? If he decided to reject it, he would have caused a good deal of time and money to be wasted.

17. Mr. SEKHON (India) said that there were clearly constraints in Austria which might make judges unwilling to grant a stay. Under the common law system, there were certain guidelines for the granting of a stay order. First, there must be a *prima facie* case for the request. Secondly, the balance of convenience must lie with the party seeking the stay. Thirdly, the party who requested it must stand to suffer irreparable injury if the stay was not granted. If he were acting as judge in such a case, he would order the tribunal to continue the proceedings but not to make an award.

18. Mr. SCHUETZ (Austria) said his delegation was in favour of the compromise drafted by the Working Group since it combined the benefit of court assistance in a challenge while minimizing the risk of delaying tactics by one or other of the parties. It also took account of all points of view and of the interests of all parties. He was not in favour of the proposal that the judge should be able to grant an interim stay, because of the implication of State liability if that decision was later reversed.

19. Mr. GRIFFITH (Australia) said his delegation concurred with the Chairman's suggestion to combine the proposals of the delegations of Bulgaria and Egypt. He saw no difficulty in common law with the granting of interim relief. There would be no question of judicial or State liability, since a court which contemplated granting an interim order for suspension would probably require the party requesting the suspension to undertake liability for any damages to the other party arising out of a subsequent reversal of the decision. Despite the fact that it would require redrafting of the opening portion of article 13 (3), his delegation preferred that the court should have power of suspension as proposed.

20. The CHAIRMAN invited the Commission to consider what would happen in a situation where the court ordered an interim suspension but the arbitral tribunal continued its proceedings in defiance of the court and made an award.

Subsequently, the final decision of the court was that the challenge, on the basis of which it had ordered the interim suspension, was unfounded. Was the award therefore invalid because it had been made in defiance of the court's interim decision, or was it validated by the court's subsequent final decision?

21. Mrs. RATIB (Egypt) said that the judgement of the court should prevail in all cases.

22. Mr. LAVINA (Philippines) said that in most judicial systems, courts had powers to enforce their decisions. With regard to the question of judicial liability, he felt that a judge would only be liable if he abused his powers.

23. Mr. KNOEPFLER (Observer for Switzerland) said that it was unlikely, in practice, that arbitrators, who were presumably worthy of trust and persons of a certain standing, would fail to respect the ruling of the court.

24. Mr. SAWADA (Japan) said that he was in favour of the text drafted by the Working Group as being the best solution.

25. Mr. TANG Houzhi (China) said that the article 13 as drafted by the Working Group constituted a reasonable compromise on the matter of court intervention, and his delegation was in favour of it.

26. Mr. LEBEDEV (Union of Soviet Socialist Republics) felt that the Commission should clarify what was meant by "final" decision. Did it mean that it was final for the parties or, alternatively, a decision not subject to appeal to a higher court? The Commission needed to be clear on whether or not a decision on a challenge would be liable to appeal to a higher Court.

27. Mr. HERRMANN (International Trade Law Branch) said that the intention of the Working Group had been that, for the sake of minimizing delay, decisions on matters of a more administrative nature, such as a challenge, should be final and not subject to appeal to a higher court.

28. Mr. LEBEDEV (Union of Soviet Socialist Republics) asked whether the finality of the decision would be interpreted in individual countries on the basis of their national procedural rules, thus allowing for a possible appeal to a higher court. It was not expressly stated in article 13 that the decision was not subject to appeal. It was important for the Commission to take a decision on the matter to avoid future misunderstandings.

29. Mr. ROEHRICH (France) said that it was difficult, when drafting, to specify that a decision was not subject to appeal. His delegation found the use of the word "*définitif*" ("final") ambiguous. However, to attempt greater precision in drafting might be very time-consuming, and it would wiser to retain "*définitif*".

30. The CHAIRMAN said that the drafting committee, if one was appointed, would attempt to find a form of words to make it clear that there was no appeal. If that proved impracticable, "*définitif*" and "final" would be retained.

31. Mr. MTANGO (United Republic of Tanzania) said he appreciated the intention to allow no appeal but was doubtful if the Model Law could override national procedural laws allowing appeal to higher courts in such cases.

32. The CHAIRMAN said that it was hoped that most countries would accept the provisions of the Model Law but

in certain instances there would, of course, be departures. The wording relating to the finality of the decision on the challenge would be drafted as clearly as possible, but the compromise would be retained. A matter particularly to be borne in mind was the difficulty of the sole arbitrator who would have to decide upon his own impartiality.

33. Mr. STALEV (Observer for Bulgaria) stressed that, in his view, article 13 did not regulate the case of the sole arbitrator.

34. Mr. HOLTZMANN (United States of America) said that the question of which court was competent remained to be decided in cases in which the place of arbitration had not yet been determined.

35. The CHAIRMAN understood that it had already been decided that where the place of arbitration was known, it would be the court in the place of arbitration. Otherwise, it would be the court of the country of the party nominating the challenged arbitrator.

36. Mr. LEBEDEV (Union of Soviet Socialist Republics) had reservations concerning the use of that formula in national legislation since he did not believe it was possible for that legislation to lay down rules of jurisdiction for the court of another country. In his view, if the place of arbitration were not known, then the competent court would be that of the State adopting the Model Law.

37. Lord WILBERFORCE (Chartered Institute of Arbitrators) suggested that an alternative might be to use the mechanisms contained in the UNCITRAL Arbitration Rules and ask the Secretary-General of the Permanent Court of Arbitration to nominate a suitable independent person.

38. The CHAIRMAN doubted whether the Secretary-General of the Permanent Court of Arbitration would be willing to discharge that function.

39. Mr. HOLTZMANN (United States of America) said that he believed the Secretary-General would do so and understood that there were precedents indicating that this had been done.

40. Mr. ROEHRICH (France) said that under a Model Law, as opposed to a convention, it was up to the individual countries incorporating the Model Law to designate, under their own national legislation, which courts would be competent. It was not possible to deal with matters of international jurisdiction in that context. The same problem applied to article 11, although the Commission had not objected when considering it, and to article 14 as well. He felt that it was not the responsibility of the Commission to deal with the question of which court had jurisdiction when the place of arbitration was not known.

41. Mr. SZASZ (Hungary) said that the Model Law should not be addressed to external bodies but should be confined to the courts of the State adopting the Model Law. With regard to the court indicated in article 6, he felt that it would not be too difficult to specify in what circumstances that court was to act.

42. Mr. BONELL (Italy) said that he shared the doubts already expressed. The Model Law was to be incorporated in the legislation of each individual State, and no State could be expected to renounce its prerogatives in the matter of jurisdiction.

43. Mr. MOELLER (Observer for Finland) said that he agreed with the view that it would not be appropriate in the context of a Model Law to specify the competence of international bodies such as that suggested by the observer from the Chartered Institute of Arbitrators.

44. Mr. SAWADA (Japan) asked if there would be discussion on whether an arbitrator who was challenged could participate in a ruling on that challenge. If not, he wished to draw the Commission's attention to his country's written submissions on that matter (A/CN.9/263, p. 24, para. 2 under article 13, second sentence).

45. The CHAIRMAN said that there was a general feeling that the challenged arbitrator should remain and thus rule on the challenge. If there were no comments, he would take it that the Commission agreed on that point.

46. *It was so agreed.*

47. The CHAIRMAN noted that there were no further comments on article 13; that article could therefore be taken as approved, on the understanding that the various drafting proposals would be duly considered.

48. *It was so agreed.*

Article 14. Failure or impossibility to act

49. Mr. BONELLI (Italy) said that although article 14 was brief, its implications were considerable. In its written comments, his delegation had proposed that the words "with appropriate speed and efficiency" should be inserted after "fails to act" (A/CN.9/263, p. 26, para. 3). A somewhat similar proposal had been made by Sweden on article 19 regarding the "prompt conduct of the arbitration" (A/CN.9/263, p. 32, para. 1). His delegation attached considerable importance to its proposal since without any such reference to the duty of the arbitrators, the text would lack an important provision. Nearly all national legislations or arbitration rules contained a provision of that kind, and article 14 was the proper place for it. His delegation, however, would welcome suggestions for another location but strongly urged approval of the substance of the proposal.

50. Mr. SCHUETZ (Austria) felt that the Model Law ought to trust the arbitrators to act with speed and efficiency. If such terms were included, it might convey the idea that the Commission assumed that they could perhaps act in some other way. He felt that the phrase "fails to act" was broad enough to cover unacceptable delay. His delegation therefore favoured retaining the article as it stood.

51. Mr. SEKHON (India) agreed fully with the Italian proposal. The expression "for other reasons" suffered from an inherent vagueness, which could be remedied by the addition of a phrase such as "with due diligence" or "with due despatch". He also questioned the use of the comma after the phrase "fails to act". He felt that it would be clearer if the sentence ran "fails to act with due despatch or if he withdraws from his office or if the parties agree on the termination, his mandate terminates".

52. Mr. SAMI (Iraq) said that his delegation also believed that arbitral proceedings should be carried out with speed and efficiency. That was precisely why the parties had resorted to arbitral procedure. Undue delay through prevarication on the part of one of the arbitrators could well be grounds for recourse by the other party and for an application for a

change of arbitrator. His delegation therefore supported the Italian proposal. The next sentence, however, did not seem to be very clear and could be interpreted in several ways. As he saw it, the sentence did not relate to the grounds for inaction but to the situation or state of the arbitrator which did not allow him to act speedily. Perhaps the sentence might run: "... if the arbitrator cannot act speedily or efficiently ...".

53. Mr. MTANGO (United Republic of Tanzania) said that speed did not mean efficiency in every case. He proposed, therefore, that only the word "efficiently" should be inserted.

54. Mr. MOELLER (Observer for Finland) pointed out that the wording of the proposal was "appropriate speed". As for the suggestion that appropriate speed and efficiency were already implied, he felt that the additional language should be introduced into the sentence in order to make it entirely clear.

55. Mr. ROEHRICH (France) wholeheartedly supported the Italian proposal.

56. Mr. HOLTZMANN (United States of America) expressed concern about the implications of the term "efficiency", which seemed to invite review of the entire nature of the arbitration proceeding. The arbitrators, who had the power to decide how the proceedings should be conducted, might, for example, ask for more written evidence than had been provided. The possibility of a court review of the efficiency of the procedure opened up a whole area going beyond the question of speed. He knew of no national law relating to arbitration which invited a judicial review of efficiency.

57. The question of speed was different: many domestic laws provided for various time periods. The insertion of the phrase "due despatch" might be of some help to arbitral proceedings. He read the related article in the UNCITRAL Arbitration Rules as requiring due despatch. While he felt there was no need for any addition, provided it was understood that article 14 did not change the UNCITRAL Rule, his delegation would not object to a phrase such as "reasonable speed" or "due despatch".

58. Mr. de HOYOS GUTIERREZ (Cuba) felt that a phrase such as "due diligence" would improve the article.

59. Sir Michael MUSTILL (United Kingdom) said that his delegation viewed with great alarm the proposal to introduce the concept of "efficiency". It seemed to invite any party dissatisfied with the way the proceedings were going to apply to a court on the grounds that there had been inefficiency. He therefore opposed the inclusion of the term. On the question of "speed" he agreed with the United Republic of Tanzania. He felt that the United Kingdom's arbitration law, which had been in effect for some fifty years, covered the point satisfactorily.

60. Mr. STROHBACH (German Democratic Republic) thought the article should be left as it stood. The reference to the performance of the arbitrators' functions implied that all the necessary steps would be taken in due time.

61. Mrs. VILUS (Yugoslavia) urged caution over the Italian proposal. It might prove difficult to interpret the terms "efficiency" and "speed".

62. Mr. SAWADA (Japan) shared the concern behind the Italian proposal. The exact wording necessary to achieve its purpose could perhaps be left to a small *ad hoc* drafting party. He suggested that "due despatch" might be appropriate.

63. Mr. ABOUL-ENEIN (Observer of the Cairo Regional Centre for Commercial Arbitration) felt that a judgement on the work of the arbitrators before it was completed, which was implied in the word "efficiency", could create problems. He would not object to the use of "speed" but would prefer to leave the article as it stood.

64. Mr. BONELL (Italy) said that his delegation was ready to withdraw the term "efficiency" in view of the criticism it had attracted. He stressed that his delegation's proposal called for "appropriate" speed; that qualification was important. If the Commission preferred the wording suggested by India, however, his delegation would be glad to accept it.

65. Mr. ROEHRICH (France) objected that it was impossible to translate "due despatch" into French.

66. Mr. MTANGO (United Republic of Tanzania) said that "due despatch" had been used for fifty years in one system of arbitration rules. It had been held in many quarters that the term "appropriate" had no legal meaning.

67. Mr. LAVINA (Philippines) said that the term "failure to act" had a meaning in law, and any adjective attached to it would be debatable.

68. Sir Michael MUSTILL (United Kingdom) said that his delegation would support the inclusion of the terms "reasonable", "appropriate" or "due".

69. Mr. HOLTZMANN (United States of America) said that his delegation could agree to "reasonable", on the understanding that its inclusion in the Model Law did not mean that it was not required in the interpretation of article 13 (2) of the UNCITRAL Arbitration Rules.

70. The CHAIRMAN stated that the proposed amendment to insert "reasonable speed" in the text was adopted, and that it was viewed as an elaboration, not a change, of the UNCITRAL Rule.

71. Mr. HERRMANN (International Trade Law Branch) said that the representative of Iraq had referred to a possible

ambiguity in the second sentence of the article with regard to the term "grounds". The reference was to the three basic instances of failure to act mentioned in the first sentence.

72. Mrs. RATIB (Egypt) suggested that the article should be divided into two paragraphs.

73. The CHAIRMAN said that, since a number of points of language had been raised, it would be wise to appoint a small *ad hoc* drafting party, consisting of the representatives of Iraq, India and the United Republic of Tanzania, to discuss the language with the secretariat and prepare an agreed text.

74. *It was so agreed.*

75. Mr. SCHUMACHER (Federal Republic of Germany) wished to reaffirm his delegation's written proposal, and that of Austria, to insert the words "unless otherwise agreed by the parties" in article 14 (A/CN.9/263, p. 26, paras. 1 and 2).

76. Mr. SCHUETZ (Austria) said that, in the interests of party autonomy, the parties should be free to agree on a procedure in cases coming under article 14.

77. Mr. HOLTZMANN (United States of America) found the written suggestion of the Federal Republic of Germany attractive. Article 13 (1) started with the words "The parties are free to agree on a procedure . . .", and the matter dealt with in article 14 was akin to challenge. The proposal of the Federal Republic of Germany was not intended to mean that there should be no possibility of a court review. The parties, who should be entitled to decide on their appointing authority, could also decide whether due speed was being exercised, and that should be made clear first, with provision for the possibility of a court review at a later stage.

78. The CHAIRMAN said that that was an entirely new proposal the acceptance of which would imply major drafting changes.

The meeting rose at 5.05 p.m.

315th Meeting

Monday, 10 June 1985, at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 9.45 a.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264)

Article 14. Failure or impossibility to act (continued)

1. Mr. SONO (Secretary of the Commission) said that the Commission had only one more week in which to finalize the Model Law. He appealed to speakers to bear that situation in mind when discussing the remainder of the draft, the whole of which had received detailed consideration in the Working Group on International Contract Practices.

2. Mr. SCHUETZ (Austria) withdrew his Government's written proposal (A/CN.9/263, p. 26, para. 1) in the interests of speeding the Commission's work.

3. Mr. SCHUMACHER (Federal Republic of Germany) said that he would withdraw his Government's written proposal (A/CN.9/263, p. 26, para. 2) if there was no strong support for it.

4. Mr. SEKHON (India) said that the agreed text called for at the previous meeting (A/CN.9/SR.314, para. 73) would be circulated in writing. It would remove some overlapping between articles 14 and 15 by transferring certain wording from the latter to the former, and would include a proposed text for article 15 as well.

5. Mr. LAVINA (Philippines), commenting on the Secretary's remark, said that he appreciated the need for rapid progress on the draft text. However, many developing

countries had been unable to attend the meetings of the Working Group and naturally wished to express their views on the draft text to other countries during the present session.

6. Mr. RAMADAN (Egypt) drew attention to the change in the article proposed by his delegation at the preceding meeting (A/CN.9/SR.314, para. 71). He too appreciated the need for the Commission to make quick progress but wished to point out that the Commission must take into account the fact that some of the developing countries had been unable to discuss the draft text in the Working Group.

7. Mr. PAES de BARROS LEAES (Brazil) proposed that, in the first sentence, the words "*de jure* or *de facto*" should be deleted and the words "with appropriate speed" be added after the word "act"; and that in the second sentence the word "otherwise" should be deleted.

8. Mr. HERRMANN (International Trade Law Branch) said that the Working Group had included the words "*de jure* or *de facto*" in order that the provision should be quite clear and also consistent with the UNCITRAL Arbitration Rules. In substance, the word "unable" would of course cover both cases.

9. Mr. HOLTZMANN (United States of America) said that his delegation favoured the proposal of the Federal Republic of Germany because it clarified the intent, although it did not change the substance. The UNCITRAL Arbitral Rules provided in general that the parties could determine how best to conduct their arbitration; in the draft text, the first sentence of article 14, taken together with article 2 (c), expressed that idea as well, and did so in a manner consistent with article 13 (2) of the Rules.

10. The CHAIRMAN noted that the Commission awaited the written text in course of preparation by the *ad hoc* drafting party set up at the previous meeting.

Article 14 bis

11. The Commission did not comment on article 14 bis.

Article 15. Appointment of substitute arbitrator

12. Mr. SEKHON (India) said that the *ad hoc* drafting party's proposed text for article 14 entailed the deletion from article 15 of the words "or because of his withdrawal from office for any other reason or because of the revocation of his mandate by agreement of the parties". In addition, article 15 should be amended to include a time-limit for the appointment of a substitute arbitrator and should read "are applicable" instead of "were applicable".

13. The CHAIRMAN said that the Commission would consider those amendments when it had the *ad hoc* drafting party's written proposal before it for articles 14 and 15.

14. Mr. REINSKOU (Observer for Norway) drew attention to his Government's written proposal, reproduced in A/CN.9/263 (p. 27, para. 2), to simplify article 15 by deleting the passage commencing with the words "under article 13 or 14" and ending with the words "termination of his mandate".

15. The CHAIRMAN suggested that the Observer for Norway should discuss his proposal with the drafting party with a view to the production of a consolidated text for articles 14 and 15.

16. *It was so agreed.*

17. Mr. LEBEDEV (Union of Soviet Socialist Republics) suggested that the consolidated text would need to be examined carefully to make sure that it did not contain any changes of substance. Article 14 covered the case where an arbitrator's mandate must be terminated, and in that circumstance the Model Law should permit an ensuing dispute to be settled in court. Article 15, on the other hand, referred to cases in which an arbitrator withdrew for his own reasons; in that situation, there might be no controversy which could be subject to any judicial control.

18. Mr. HOLTZMANN (United States of America) drew attention to an anomalous situation which could arise under article 15: if the claimant failed to nominate the substitute arbitrator, the effect of the earlier part of the draft would be that he would be nominated by the court in the respondent's country. He thought that article 15 should contain a proviso to prevent that.

19. The CHAIRMAN suggested that the problem might be solved by appropriately redrafting article 11, and that it should be left to a drafting committee.

20. *It was so agreed.*

21. Mr. PAES de BARROS LEAES (Brazil) suggested that the words "unless the parties agree otherwise" at the end of the article should be deleted, as they could cause complications by permitting a situation in which there might be no provision for the appointment of a substitute arbitrator.

22. The CHAIRMAN said the effect of that change would be to place the parties in the same position with regard to the appointment of a substitute arbitrator as with regard to the appointment of the original arbitrator. The matter would thus be governed by article 11. He thought the Commission would wish to accept the Brazilian suggestion.

23. *It was so agreed.*

Article 16. Competence to rule on own jurisdiction

Article 16 (1)

24. Mr. SEKHON (India) suggested that the words "unless otherwise agreed by the parties" should be inserted at the beginning of the paragraph, with a view to the provision gaining wider acceptance.

25. The CHAIRMAN said he felt that the Commission might prefer to indicate in the report that parties could contract out of the provision in paragraph (1).

26. Mr. BONELL (Italy) supported the Chairman's suggestion.

27. Mr. MTANGO (United Republic of Tanzania) said that the words "the arbitral tribunal has the power to rule on its own jurisdiction" were too strong and might conflict with national laws. If the Commission's aim was to provide a Model Law for Governments and not to change the existing pattern of national legislation, it should perhaps use less forceful wording for provisions which might give rise to conflicts of that kind. He therefore suggested amending the words "has the power" to read "may be granted the power".

28. Mr. SZURSKI (Observer for Poland) said that the first sentence of paragraph (1) might give the impression that an

arbitral tribunal would not be competent to rule on its own jurisdiction unless an objection had been raised by one of the parties. In that connection, paragraph 3 of section A of the secretariat's commentary on the article (A/CN.9/264, p. 38) suggested that the tribunal should be able to make certain determinations *ex officio*, for example on the arbitrability of a dispute. He therefore suggested that the word "objections" should be replaced by the word "questions".

29. The CHAIRMAN agreed that the tribunal should be able to take such decisions of its own motion. They would not of course be final ones, because of the judicial setting-aside procedure, but he doubted whether the change suggested by the Observer for Poland would make the matter any clearer.

30. Mr. RAMADAN (Egypt) said that his delegation read article 16 as implying that the parties could resort to the court under article 8 for a decision on the validity of an arbitration agreement. However, the draft text also contained article 34, the aim of which was that only one opportunity for judicial recourse should be available to them. His delegation would make a proposal under article 34, designed to eliminate the possibility of objections to the validity of an arbitration agreement being made to a court more than once.

31. He did not think it was necessary for the Commission to adopt the Tanzanian suggestion since the national legislator would be able to eliminate conflicts between the Model Law and existing national legislation.

32. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that article 16 was very important for arbitrators: an arbitral tribunal must be clear about its power to rule on its own competence. The Tanzanian representative had suggested that the rule should be expressed less forcefully. He himself did not think that the present wording would create a problem for the Institute or for most States, but perhaps the point might be met by substituting the word "may" for the words "has the power to".

33. Mr. MTANGO (United Republic of Tanzania) accepted that suggestion.

34. Mr. MATHANJUKI (Kenya) said that the Working Group on International Contract Practices had deleted from the Model Law the article dealing with concurrent court control, namely article 17. It therefore seemed necessary for the Commission to clarify the role of the court in the event of a dispute between the parties concerning jurisdiction. Under article 5, the court could not intervene except where the Model Law so provided. Article 16 should therefore provide some linkage with the court system in regard to decisions by an arbitral tribunal about its competence.

35. Mr. HOLTZMANN (United States of America) said that he could accept the substitution of the word "may" for the words "has the power to" provided that it was understood that it would not render the paragraph weaker than article 21 (1) of the UNCITRAL Arbitration Rules, which used the words "shall have the power to".

36. The CHAIRMAN noted that there was no objection to the suggestion made by the Chartered Institute of Arbitrators, and that this formulation was no weaker than the original.

Article 16 (2)

37. Mr. LEBEDEV (Union of Soviet Socialist Republics) referred the Commission to his delegation's written com-

ments, reproduced in A/CN.9/263 (p. 28, para. 3). In order to meet the need for promptness in raising pleas of excess of authority, his delegation proposed that the third sentence of paragraph (2) should be replaced by the following wording, taken from article V(1) of the 1961 European Convention: "Pleas based on the fact that an arbitrator has exceeded his terms of reference shall be raised during the arbitration proceedings as soon as the question on which the arbitrator is alleged to have no jurisdiction is raised during the arbitral procedure." That change would not affect the substance of the paragraph and would make its intention clearer.

38. Mr. MOELLER (Observer for Finland), Mr. LOEFMARCK (Sweden) and Mr. HOELLERING (United States of America) supported the Soviet Union proposal.

39. Mr. LAVINA (Philippines) said that in some legal systems objections to jurisdiction could be raised at any stage of the proceedings, but he agreed that under the Model Law they should be made as early as possible.

40. Mr. ILLESCAS ORTIZ (Spain) said that paragraph (2) was generally acceptable to his delegation. He suggested that in the Spanish version of the second sentence the expression "*cuestión de competencia*" should be substituted for the term "*declinatoria*".

41. Mr. BONELLI (Italy) supported the Soviet Union proposal. The present wording of the third sentence of paragraph (2) might be misunderstood to mean that the question of acting in excess of authority could not be raised until the arbitrators themselves had declared their intention of so acting. It was possible, however, that during the proceedings a party might raise a matter falling outside the scope of the original arbitration agreement. If the other party did not agree to the arbitrators' terms of reference being broadened to include it, he should raise his objection immediately. The wording of the 1961 European Convention brought that out more cogently than the present draft of the paragraph. It was important that the paragraph should make it clear that a plea of excess of authority could be made as a result not only of an initiative by the arbitrators but also of an act of a party.

42. Mr. ROEHRICH (France) said that his delegation supported the Soviet Union proposal, for the reasons given by the representative of Italy.

43. Mr. SEKHON (India) also supported the Soviet Union proposal. He suggested the deletion of the word "in" from the first sentence of paragraph (2) on the grounds that it was superfluous and also misleading, as suggesting that a plea to the jurisdiction could be raised only in the statement of defence.

44. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that paragraph (2) dealt adequately with two possibilities, namely that the arbitral tribunal had no jurisdiction and that it was exceeding the scope of its authority. He could accept the Soviet Union proposal but marginally preferred the text as it was.

45. Sir Michael MUSTILL (United Kingdom) said that the Working Group had had good reasons for adopting the present wording. However, there appeared to be a strong feeling in the Commission in favour of the Soviet Union proposal, and his delegation would not oppose it.

46. Mr. SZASZ (Hungary) supported the Soviet Union proposal but observed that the system provided for in the 1961 European Convention was less flexible than what the Model Law proposed.

47. Mr. LAVINA (Philippines) pointed out that the Convention referred to an arbitrator exceeding his terms of reference, whereas the Model Law was speaking of an arbitral tribunal. He was not sure how the Soviet Union proposal would overcome that discrepancy.

48. Mr. MTANGO (United Republic of Tanzania) said that if the Commission adopted the wording of the Convention, it would be introducing a rigid procedure that might create problems, especially for the developing countries, where persons involved in arbitral proceedings might lack the experience to realize the need for promptness. He preferred the present text, which was more flexible.

49. Mr. MARTINEZ CELAYA (Observer for Argentina) supported the proposed Soviet amendment. With regard to the drafting change suggested for the Spanish version, his delegation would prefer the word "*declinatoria*" to be retained, since it was quite appropriate in the context.

50. Mr. ALLIN (Observer for Canada) and Mr. STROHBACH (German Democratic Republic) also supported the Soviet Union proposal.

51. Mr. BONELL (Italy) asked whether a party's failure to raise an objection under article 16 would later preclude him from seeking to have the award set aside or from refusing to recognize it or accept its enforcement. The secretariat's commentary (A/CN.9/264, p. 39, para. 9) appeared to support that interpretation. The Model Law should distinguish between an objection that the arbitral tribunal had exceeded its authority, which could not be taken before the court designated in article 6, and an objection on any other ground, which could.

52. The CHAIRMAN proposed that this matter be discussed in connection with articles 34 and 36 and noted that there was no objection.

Article 16 (3)

53. Mr. SAWADA (Japan) said he agreed with the secretariat's remarks in paragraph 14 of its commentary on the article (A/CN.9/264, p. 41) and its suggestion that the arbitral tribunal should be free to cast its ruling either as an award, subject to court control, or as a procedural decision which could only be contested in an action for setting the award aside.

54. Mr. MOELLER (Observer for Finland) said that the second sentence of article 16 (3) was inconsistent with article 8 and should be deleted.

55. Mr. REINSKOU (Observer for Norway) said that his Government's written proposal, reproduced in A/CN.9/263 (p. 29, para. 7 (b)), was a compromise between the present text of article 16 (3) and the article 17 deleted by the Working Party. It would allow the arbitral tribunal to make a ruling on its own jurisdiction in a final decision or in a separate preliminary decision. Alternatively, the procedure provided for in article 13 could be used.

56. Sir Michael MUSTILL (United Kingdom) said that the statement in article 16 (3), to the effect that a ruling by the

arbitral tribunal that it had jurisdiction could not be contested except in an action for setting the award aside, was not correct since a party could also apply for refusal of recognition or enforcement of the award under article 36.

57. In the view of his delegation, article 16 (3) should not be considered without the deleted article 17. There was no question of the right of the court to intervene on matters concerning the jurisdiction of the arbitral tribunal; the only doubt concerned the stage at which its intervention should be allowed. If article 17 were reinstated, the suggestion made by the secretariat in paragraph 14 of its commentary would be acceptable.

58. Mr. MARTINEZ CELAYA (Observer for Argentina) said that the arbitral tribunal's ruling on its own jurisdiction should be made at an early stage in the case in order to save the parties money, ensure due process and prevent what was called "forum shopping".

59. Mr. HOLTZMANN (United States of America) said that to his knowledge an arbitral tribunal could always leave the question of its own competence in its award on the merits, so that it could only be reviewed by a court first in an action for setting aside the award on the merits. The compromise solution suggested by the secretariat (A/CN.9/264, p. 41, para. 14) would enable the arbitral tribunal to decide the matter of its own jurisdiction either in an interlocutory award, which would allow the parties immediate recourse to the court, or in a less formal decision, which would not.

60. Mr. SCHUETZ (Austria) said that the question of an arbitral tribunal's jurisdiction should be decided at a very early stage. His delegation considered that article 16 (3) should contain a provision similar to article 13 (3); it should set a short period of time for the court's decision and stipulate that it would be final.

61. Mr. STALEV (Observer for Bulgaria) said that his delegation supported article 16 (3), even without article 17, since the claimant was not likely to raise a claim unless the arbitration agreement was valid.

62. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that an arbitral tribunal was often reluctant to declare that it did not have jurisdiction in a case, because the claimant might have no other remedy. He suggested that a fourth paragraph should be added to article 16 to the effect that, notwithstanding paragraph (3), an arbitral tribunal which had ruled that it had jurisdiction over a case might authorize the parties to ask the court mentioned in article 6 to review that ruling. In regard to the suggestion that an arbitral tribunal should be free to make either a preliminary award or a procedural decision, it did not seem right that the court's power to intervene should depend merely on the name given to the tribunal's decision. The Austrian representative had suggested that the court should be empowered to take a final decision on the arbitral tribunal's jurisdiction, but the parties would then have no further recourse.

The meeting rose at 12.35 p.m.

316th Meeting

Monday, 10 June 1985, at 2.00 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 2.10 p.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264)

Article 16. Competence to rule on own jurisdiction (continued)

1. Mr. GRIFFITH (Australia) said that his delegation was in favour of the reinstatement of article 17. In that case, the second point in article 16 (3) need not be considered.

2. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that the restoration of article 17 after its deletion by the Working Group would remove a substantial element of the compromise that had been arrived at. His delegation had accepted the decision to keep article 8 on the understanding that the whole compromise would be maintained. It should therefore be adhered to in respect of the other articles. Article 16 should be regarded as an indispensable element of the compromise in regard to the substantive question of the relationship between the arbitral tribunal and the court.

3. Mr. MTANGO (United Republic of Tanzania) said he strongly supported the restoring of article 17.

4. Mr. SZASZ (Hungary) was prepared to accede to giving more control to the courts than in the draft prepared by the Working Group. One way of doing so would be to restore article 17.

5. Mr. MOELLER (Observer for Finland) thought that article 17 should be restored. He was not sure that it had been the right course to treat article 16 separately.

6. Mr. GRAHAM (Observer for Canada) favoured restoring article 17, but as modified on the lines suggested by Austria and Norway.

7. Mr. PAES de BARROS LEAES (Brazil) thought that article 17 should be reconsidered as originally drafted.

8. Mr. HOLTZMANN (United States of America) said that his delegation's first preference was for the draft of the Working Group without article 17. It was prepared to consider as an alternative the proposal put forward in paragraph 14 of the secretariat's comments, in the form described by the observer for the International Council for Commercial Arbitration. If that solution was adopted, there would be a need for article 17 with regard to those situations in which there was an appeal to the court. The third and least acceptable solution would be on the lines suggested by Austria and endorsed by Canada. His delegation reserved the right to discuss the drafting suggestions made in respect of article 17 at a future stage.

9. His delegation also agreed with the Norwegian and other delegations which had suggested that challenges to jurisdiction, when made, should be regarded not simply as actions for setting aside but also as a form of defence in an enforcement action. Regarding the secretariat's comments in paragraphs 11 and 12 on the ruling by the arbitral tribunal and judicial control, he noted that jurisdictional questions were "more often" rather than "usually" ruled upon first, and that it was not particularly exceptional for an arbitral tribunal to include

in an award on the merits a ruling to the effect that it had jurisdiction.

10. Mr. ROEHRICH (France) said that, in his delegation's view, the future of international commercial arbitration did not lie in continual recourse to the court of the place of arbitration. His delegation therefore had great difficulty in respect of article 17 but was nevertheless ready to try to find a compromise. It did not think, however, that the solution lay in giving the arbitrators discretionary power to decide whether there could be recourse to the court on the question of jurisdiction during the arbitral proceedings. The suggestion of the observer from the International Council for Commercial Arbitration was very dangerous. If some formula could be found for setting a time-limit, his delegation could accept it, in a spirit of compromise, but it could not accept that the decision should be left to the arbitral tribunal itself. Questions of competence should be dealt with only at the time of an action for setting aside an award. If there was to be continual recourse to the court of the place of arbitration, there was a great risk that arbitration would cease to exist in countries where it was all too easy to paralyse the proceedings by turning for one reason or another to the State courts.

11. The CHAIRMAN said that there seemed to be no clear majority either for reinstating article 17 as it stood or for deleting article 17 and keeping article 16 (3) unchanged. He suggested, as a possible compromise, a system in which the parties could require the arbitrators to rule on their own jurisdiction in a preliminary matter but in which that ruling could be the object of recourse to the court, though perhaps confined to a single level of jurisdiction in order to save time; in the meantime, the arbitrators would be able to continue their proceedings.

12. Mr. HOLTZMANN (United States of America) said that if the parties were empowered to demand that the question of jurisdiction should be settled as a preliminary matter, they would be able to dictate to the arbitrators the time when they would decide the issues before them and thereby infringe on their power to deal with the issues as they thought best. Arbitral tribunals operating under the UNCITRAL Arbitration Rules found it valuable to allow for the intertwining of the question of jurisdiction and the substantive issue.

13. Mr. MATHANJUKI (Kenya) favoured reintroducing article 17. Regarding the Chairman's proposal, he said that article 16 (3) might be amended to ensure that the parties had the right to require a preliminary decision.

14. Mr. BARRERA GRAF (Mexico) said it needed to be made clear whether article 16 (3) applied to the plea that the arbitral tribunal was exceeding its authority as well as to the plea that it had no jurisdiction. Also, in respect of article 16 (3), his delegation felt that the problem of jurisdiction was so important that it should be decided by the arbitral tribunal as a preliminary question. The decision, however, should not prevent the continuation of the proceedings, unless otherwise provided for in the arbitration agreement. The question of the tribunal having exceeded the scope of its authority, as referred to in article 16 (2), could be

decided either as a preliminary question or jointly with an award on the merits. If article 16 (3) was redrafted, it should incorporate the terms of the deleted article 17, to the effect that a party could request the court to decide whether a valid arbitration agreement existed. Unlike article 17 (1), however, it would rest with the arbitration agreement whether the proceedings should continue or be suspended.

15. Mr. SZURSKI (Observer for Poland) supported the opinion that the question of the jurisdiction of the arbitral tribunal should be settled as soon as possible and that the parties should not be deprived of the possibility of objecting to the prolongation of the arbitral proceedings if they believed the tribunal lacked jurisdiction. There were occasions on which the arbitrators were interested in prolonging the proceedings for their own reasons, and the parties should be protected in cases where they were convinced that the arbitral tribunal had no jurisdiction. Article 16 (3) should therefore be amended in the way suggested by the Chairman: on the request of a party, the arbitral tribunal should be obliged to render a preliminary decision on the question of jurisdiction so that immediate recourse to the court would become possible. There should, however, be a time-limit so as to prevent abuse and dilatory tactics.

16. Sir Michael MUSTILL (United Kingdom) said that the Chairman's suggested solution seemed in essence to be the same as that of the representative of Austria. The parties would proceed in two stages: first, there would be a challenge before the tribunal, to be followed secondly by a rapid approach to the court, subject to the conditions laid down in article 13. If the two proposals were indeed the same, his delegation would be able to support the Chairman's suggestion. He noted in passing that, although article 16 (3) said that a ruling by the arbitral tribunal that it had jurisdiction could be contested in the court, none of the proposals so far had addressed a situation in which the arbitrators decided that they had no jurisdiction. Could the parties then claim that they did? He believed that article 13 operated in both directions and there seemed to be no logical reason why article 16 should not do the same.

17. The CHAIRMAN thought that there was a substantive reason, in that the arbitrators could not be forced to continue their arbitration if they believed that they had no jurisdiction. The arbitration proceedings would thus be terminated.

18. Sir Michael MUSTILL (United Kingdom) said that the party making the plea could then take the matter to the court. The question would then arise before the court whether the arbitration agreement was operative and whether the matter should then be stayed under article 8.

19. The CHAIRMAN said that, in his opinion, the arbitration proceedings were clearly terminated and the arbitration agreement could no longer be invoked before a court.

20. Mr. GOH (Singapore) said that his delegation supported the reintroduction of article 17. Since it might be abused for delaying purposes, however, he also saw merit in the Austrian proposal as amplified by the representative of the United Kingdom.

21. Mr. RAMADAN (Egypt) was in favour of maintaining article 16 (3) as it stood. If a party wished to dispute the arbitral tribunal's ruling that it had jurisdiction, it must wait until after the issuing of the award.

22. Mr. SEKHON (India) said that his delegation had originally preferred the revival of article 17 but could accept

the compromise solution suggested by the Chairman. There had been some debate on whether the court would have jurisdiction to intervene in the case of an interlocutory order as well as in that of an interim award. His delegation believed that it was the substance of the order which mattered and not the form.

23. Mr. HOLTZMANN (United States of America) said that his delegation considered the question extremely serious from the point of view of the acceptability of the Model Law and of the whole future of the institution of arbitration. Given the potential for delay in the system suggested, he thought it unlikely that anyone would choose to go to arbitration at all. The suggested compromise incorporated some of the worst features of the possibilities for delay.

24. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that a solution residing in the retaining article 16 (3) without article 17 would be totally unacceptable to the profession as it would place arbitrators in an impossible position. For example, a question raised as to the jurisdiction of an arbitral tribunal might involve many difficult points, including both elaborate questions of fact to be tried on evidence and difficult points of law. It was altogether unacceptable to force the arbitrators in these circumstances to go on with the proceedings and reach an award after a long and expensive hearing only to have the award challenged under articles 34 and 36. In his experience, far from resisting applications to the court, arbitrators were in favour of a court ruling. They would make their own ruling on a point of law to the best of their ability but they would not wish to proceed further until it had been decided whether that ruling was right or wrong. Some possibility of control by the court at an early stage was thus desirable. The arbitrators should certainly have the option, at their discretion, of joining the question of jurisdiction to the merits of the case, but they should also have the option of giving their best ruling on the legal question and then having it decided by the court. Since, according to the Chairman's suggestion, the arbitration would end if the arbitrators were to decide that they had no jurisdiction, they would almost certainly rule that they had, despite any doubts they might have, in the understanding that there would be a court decision on the matter at an early stage. His organization could therefore support an optional intermediate solution. Whether to go further and respect the wishes of the parties to force the arbitrators to go to the court depended on how far arbitrators were trusted. He concurred in the view of the observer for the International Council for Commercial Arbitration that, in general, arbitrators were to be trusted. The provisions of the Model Law ought to go further only if it was believed to be absolutely necessary in the interests of the parties.

25. Mr. SCHUMACHER (Federal Republic of Germany) supported the Austrian proposal. His main concern was that whatever solution was adopted, the arbitration procedure should not be stopped by an appeal to the court.

26. Mr. SCHUETZ (Austria), explaining his proposal, said that his delegation's basic idea had been that there should be court control as early as possible, but its position was a flexible one. If the arbitral tribunal made a ruling on jurisdiction in conjunction with the award on the merits, the decision on jurisdiction would be taken in the setting-aside procedure. If, however, the arbitral tribunal made a preliminary decision on jurisdiction, his delegation would propose a system similar to that set out in article 13 (3).

27. Mr. LOEFMARCK (Sweden) said he was in favour of retaining article 16 (3) as it stood and did not wish article 17 to

be reintroduced. If the arbitral tribunal found that it had no jurisdiction, then the competent body must be the court, according to the rules of general jurisdiction. No one could be prevented from bringing a dispute before a court unless there was a valid arbitration clause, but it was precisely that question which the court had to decide if the parties were not agreed. If article 17 was reintroduced, it might be possible for the court specified in article 6 to reach a different decision from the court which should properly take up the dispute. His delegation found that possibility quite unacceptable.

28. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that in the course of deliberations it had been pointed out that the arbitration proceedings might continue and that the arbitral tribunal might even take a decision on substance while the question of jurisdiction was still under consideration by the court. It should, however, be realized that in such a case the arbitral award would be deprived of legal significance pending the court decision on jurisdiction. It was impossible to set a limit on the time it might take for that matter to be decided by the court of first instance and even more so by the appeal court. In fact, the attempt to speed up proceedings might merely result in considerable delay. However, he had been impressed by the argument of the observer for the Chartered Institute of Arbitrators that in difficult cases the arbitrators themselves were interested in having the question of jurisdiction settled by the court. As a compromise, the Model Law might therefore cover the possibility of the arbitral tribunal taking, at its discretion, an interlocutory decision on jurisdiction in complex cases which could be appealed to the court. But at the same time, there should not be a rule making it possible in all cases without exception to resort to the court for a decision on the arbitrator's jurisdiction.

29. The CHAIRMAN said the majority appeared to favour allowing the question of the jurisdiction of the arbitral tribunal to be decided by a court at an earlier stage than the award. However, not many members of the Commission were in favour of the reintroduction of article 17. It would appear to be easiest to find a compromise on the basis of the Austrian proposal. It was true that it might be used for delaying tactics, but if the court proceedings on jurisdiction were sufficiently delayed, they could always be joined to the appeal proceedings against the award. He therefore suggested that the secretariat, with the assistance of the Austrian representative, should draft a text for further consideration by the Commission.

30. Mr. GRIFFITH (Australia) observed that both the United Kingdom delegation and his own delegation had associated themselves with the Austrian proposal if article 17 was not to be reintroduced. He suggested that the United Kingdom representative might assist the secretariat together with the Austrian representative.

31. The CHAIRMAN suggested that the Australian representative might also assist the secretariat.

32. Mr. MIFANGO (United Republic of Tanzania) said that the possibility of resurrecting article 17 should be left open in case the Austrian proposal did not prove satisfactory.

33. Mr. HOLTZMANN (United States of America) said that no one had spoken against the Norwegian proposal to the effect that a challenge to jurisdiction should not only be regarded as an action to set aside an award but also as a defence to a court action for recognition and enforcement of an award. The Austrian representative's draft might include that point.

34. The CHAIRMAN suggested that matter would be more appropriately discussed in conjunction with article 36.

35. *It was so agreed.*

Article 18. Power of arbitral tribunal to order interim measures

36. Mr. SEKHON (India) said that article 18 appeared to overlap with article 9 as far as the subject-matter of the dispute was concerned. Both the court and the arbitral tribunal had power to order interim measures. In the event of contradictory orders, presumably the court order would prevail on penalty of contempt of court. Would an order by the arbitral tribunal be enforceable?

37. Mr. HERRMANN (International Trade Law Branch) said the question had been raised before. The main consideration was whether the Commission wished to deal with the matter in the Model Law. The two articles, as far as purpose was concerned, were not in conflict. Article 9, as the Commission had already agreed, dealt merely with the question of compatibility between the agreement of the parties to arbitrate and the request to a court for interim measures or the decision of that court to grant such measures. It did not relate to the question of which measures might be available under a given legal system. In that context, it was his understanding that the Commission had wished article 9 to have a global scope of application. The court, if it wished to grant an interim measure, ought not to be precluded from doing so by the existence of an arbitration agreement, irrespective of where the arbitration was taking place, and the request to a court of whatever country was compatible with, and did not constitute a waiver of, an arbitration agreement governed by the Model Law.

38. Article 18 merely stated that the arbitral tribunal had an implied power to order certain interim measures, unless otherwise agreed by the parties. Since under some national legislations an arbitral tribunal did not have such powers, that point should be clarified. If properly analysed, the articles in themselves did not create a conflict, but there was always the possibility that a conflict might arise, bearing in mind the global scope of article 9, which covered the possibility for a party to request a decision from a court in a country other than that under consideration.

39. Mr. BARRERA GRAF (Mexico) noted that in the comments by Governments, Austria had suggested the deletion of article 18 (A/CN.9/263, p. 31, para. 1). In any case, the powers of the arbitral tribunal under that article would have to be restricted. However, article 18 was probably not required at all in view of the clarification on the scope of article 9 just given by the secretariat. If, however, it was retained, it should be amended, as Mexico had already suggested, so as to provide that the security which the arbitral tribunal might require from a party should cover possible damage suffered by the other party as well as the costs of the interim measure itself.

40. Mr. HOELLERING (United States of America) suggested that, as previously agreed with regard to interim measures available from a court, the record of the discussion on article 18 should also reflect that, under appropriate circumstances, the arbitral tribunal would be entitled to order the protection of trade secrets and proprietary information.

41. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators), referring to the Mexican proposal,

pointed out that the secretariat commentary on article 18 stated that the security required by the arbitral tribunal "may also cover any possible damages" (A/CN.9/264, p. 43, para. 5). It was not clear whether that was intended to mean that the present wording of article 18 covered that contingency or to recommend that it should be extended to do so. He would be in favour of the inclusion of a provision on damages.

42. Mr. ILIESCAS ORTIZ (Spain) said he was disposed to support the Mexican proposal regarding damages; the damages might also cover loss of profit by the affected party. It would not, however, be an easy matter to assess the cost of either the interim measure or the necessary cover for damages.

43. The CHAIRMAN said that it would be better not to enter into detail but to refer to "reasonable security", leaving it to the arbitrators to determine what was reasonable for the purpose.

44. Mr. HOLTZMANN (United States of America) drew attention to article 26 (2) of the UNCITRAL Arbitration Rules, which contained language nearly identical to the present draft. In the absence of any strong reason for thinking that those Rules were inadequate, they should be retained, in order to minimize confusion.

45. Mr. TANG Houzhi (China) said it was his understanding that under articles 9 and 18, a party might submit a request for interim measures either to the court or to the arbitral tribunal. Under the Chinese legal system, a party had to submit such a request to the arbitral tribunal, which, if it deemed the request receivable, referred it to the court for a ruling. He asked whether it was possible to submit a request for interim measures both to the court and to the arbitral tribunal.

46. The CHAIRMAN said that in theory the answer was in the affirmative, but it would be a matter of court procedure whether the court was competent to consider a request for interim measures while a request for such measures was pending with the arbitral tribunal. An affirmation of the UNCITRAL Arbitration Rules would imply that parties might address themselves to one or to the other body.

47. Mr. ROEHRICH (France) said that his delegation had no objection to the suggestion made by the representative of Mexico but thought that the amount of the damages should be indicated in the text. He did not agree with the representative of the United States that the Commission must use the UNCITRAL Arbitration Rules as its ultimate authority in drafting the Model Law. These Rules covered certain specific situations, and the Commission was not necessarily bound by them, especially if it could arrive at a better formulation more relevant to the specific purpose which the Model Law was intended to serve.

48. Mr. HOLTZMANN (United States of America) said that the term "reasonable security" or "appropriate security" was acceptable because the UNCITRAL Arbitration Rules were quite broad and allowed recovery of all damages that resulted.

49. After a procedural discussion in which Mr. ROEHRICH (France), Mr. HOLTZMANN (United States of America) and the CHAIRMAN took part, the CHAIRMAN noted that during the Commission's discussions, it had been suggested that the formulation of the final sentence of article 18 would be slightly improved if "reasonable" were inserted before "security". If there were no objection, he would take it that the Commission agreed to keep article 18 with that improvement.

50. *It was so agreed.*

Article 19. Determination of rules of procedure

Article 19 (1)

51. Mr. HOLTZMANN (United States of America) said that the freedom of the parties to agree on arbitral proceedings should be clearly acknowledged to be a continuing right and not one to be exercised only during the period preceding the arbitration.

52. Mr. BONELL (Italy) said that in its written observations, Italy had suggested that the text should stipulate that the freedom of the parties to agree on whatever procedure they desired ended with the start of the proceedings, unless the arbitrators themselves agreed to the proposed modification. After having been given certain terms of reference, the arbitrators should not be obliged to adopt an entirely different procedure. Since the Model Law did not define the contractual relations between the arbitrators and the parties, it must at least specify that changes could be made only with the consent of the arbitrators.

53. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that when the Working Group had discussed the issue, the majority had favoured granting the parties a continuing right to decide on the procedure. The comment made by the representative of Italy was, however, a very valid one.

54. Mr. HERRMANN (International Trade Law Branch) added that in its discussion of article 26 on the appointment of experts by the arbitral tribunal, the Working Group had concluded that an agreement on such appointment should be recognized only if it was made before the arbitration began. In general, however, the Working Group had favoured the more flexible approach of enabling the parties to change the rules of procedure at any stage.

55. The CHAIRMAN said that arbitration entailed a contractual relationship not only between the parties but also between the parties on the one hand and the arbitrators on the other; that second aspect involved the mandate and remuneration of the arbitrators. The points made by the representatives of the United States and Italy raised the issue of what an arbitrator could and should be expected to do in all fairness. If the arbitrators objected to being asked to change their procedure after the proceedings had begun, they could always demand to be released from their responsibilities and be paid accordingly.

56. Mr. LAVINA (Philippines) said that although the parties could be expected to be reasonable regarding changes in the arbitral procedure, there was no way of ensuring that they would be. For that reason, the United States proposal could cause extensive complications, whereas the Italian proposal would result in an overly rigid régime. His delegation favoured the text as it stood.

57. Mr. BONELL (Italy) said that his country's proposal was intended to make it clear that the parties were permitted to change the procedure to be followed, subject to the agreement of the arbitrators. The Chairman had noted that arbitration was based on a contractual relationship between the parties and the arbitrators: it was a general principle of contractual law that the content of a contract could not be changed unilaterally. Flexibility in arbitration proceedings was a universally recognized principle, but the parties must at some point take a final stand.

58. Mr. AYLING (United Kingdom) said that the comments made by the representative of Italy had great merit. It should be acknowledged in the Model Law that the arbitrators had a contractual interest in the terms of the arbitral proceedings and that they should be able to consent to or to reject those terms.

59. The CHAIRMAN pointed out that if that were the case, the parties could terminate the mandate of the arbitrators at any time. Although he personally did not endorse the Italian proposal, it seemed that many members of the Commission did.

60. Mr. MTANGO (United Republic of Tanzania) said that he endorsed the Italian proposal.

61. In reply to a question by Mr. de HOYOS GUTIERREZ (Cuba), the CHAIRMAN said that if the parties agreed on institutional arbitration, they thereby also agreed to abide by the rules of procedure of the institution in question.

62. Mr. JARVIN (International Chamber of Commerce) said that in its written comments, his organization had proposed that where the parties had referred to the rules of procedure of a given institution, they should be deemed to have agreed that the arbitration would be conducted in accordance with those rules. Article 19 (1) seemed to require that the parties make an express agreement at the start of the arbitration.

63. Mr. SAWADA (Japan) said that the Working Group had produced its text after extensive negotiations and that it would be inadvisable to depart from that text.

64. Mr. LOEFMARCK (Sweden) said that he supported the Italian proposal but felt that the proper time for agreement to be reached between the parties and the arbitrators was at the start of the proceedings, not when the arbitrators had already accepted their duties.

65. Mr. SZASZ (Hungary) said that the text should be retained as it stood; the Commission's discussion, which was really an interpretation of the text, would be reflected in the summary record.

66. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that the text provided that the parties had a continuing right to change the procedure, but that the arbitrators did not have to accept anything they had not specifically agreed to and would consequently have the last word regarding the procedure. The Commission's discussion proved that the general formulation used in the text was more appropriate than a more precise wording, which would only lead to difficulties and confusion.

67. The CHAIRMAN said that, after all, the time-frame allowed for changing the procedure to be followed could be settled by contract between the parties and the arbitrators. If he heard no objection, he would take it that the Commission wished to leave the text of article 19 (1) as it stood.

68. *It was so agreed.*

Article 19 (2)

69. Mr. BONELL (Italy) said that the second sentence would create difficulties in respect of Italian law, since the

admissibility, relevance, materiality and weight of evidence fell within the scope of Italian substantive law.

70. Mr. HERRMANN (International Trade Law Branch) said that one or the other of the subjects mentioned in the final sentence might be regarded in some legal systems as relating to substantive law. Nevertheless, it was not inappropriate for a Model Law on arbitration to deal with the procedure of taking and weighing evidence. Regarding the compatibility within the Model Law itself between article 19 (2) and article 28, it was the secretariat's view that if the Model Law was adopted as it stood, admissibility and the other issues mentioned in article 19 (2) would be decided upon at the discretion of the arbitral tribunal, unless otherwise agreed by the parties, and would not be affected by the choice of substantive law to be made under article 28.

71. Mr. BONELL (Italy) said that he agreed with Mr. Herrmann that there was a major difference between article 19, in which the word "Law" was used, and article 28, which referred to "rules of law". His delegation would prefer article 19 (2) to be amended to conform to the wording of article 28, which was broader. With that amendment, the text would clearly show that a strictly nationalistic approach must not be taken in respect of substantive law. The arbitrators would clearly have the power to decide for themselves questions of admissibility, relevance, materiality and weight of evidence, as they would no longer be bound by the application of a specific national law. If the final sentence was not amended along those lines, his delegation proposed that it should be deleted.

72. The CHAIRMAN suggested that another option might be to add, at the end of the final sentence, the phrase "subject to the binding provisions of the applicable law".

73. Mr. PELICHET (Observer for the The Hague Conference on Private International Law) said that he did not understand the Italian delegation's problem with the text. As he read it, the final sentence simply indicated the powers of the arbitrators in respect of admissibility of evidence but did not dictate which national law, whether substantive or procedural, they would use in their judgement on admissibility.

74. Mr. HOLTZMANN (United States of America) said that in its written observations, the International Chamber of Commerce had proposed an addition to article 7 referring specifically to arbitration administered by a permanent institution (A/CN.9/263/Add.1, p. 7, para. 8). His delegation believed that the Model Law should not refer to the rules of a permanent institution but that where the parties had agreed to refer any dispute to arbitration under specific procedural rules, the arbitration must be conducted in accordance with those rules, in so far as they did not conflict with the mandatory provisions of the Model Law. He therefore suggested that article 19 (2) should be amended to include a reference to the observance of such procedural rules.

75. Mr. MTANGO (United Republic of Tanzania) requested that the text of the amendment the representative of the United States had in mind be distributed to members of the Commission.

76. The CHAIRMAN suggested that, if the Commission agreed, it should resume its discussion of article 19 (2) following completion of the discussion of article 28.

77. *It was so agreed.*

The meeting rose at 5.15 p.m.

317th Meeting

Tuesday, 11 June 1985, at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

*The meeting was called to order at 9.40 a.m.*International commercial arbitration (*continued*)

(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264)

Article 34. Application for setting aside as exclusive recourse against arbitral award

Article 34 (1)

1. Mr. de HOYOS GUTIERREZ (Cuba) proposed that the words "recourse to a court" should be amended to read "recourse to a competent court", so as to bring out the link between article 34 and article 6.

2. The CHAIRMAN suggested that the proposal should be submitted to a drafting committee.

3. *It was so agreed.*

Article 34 (2)

4. Sir Michael MUSTILL (United Kingdom) expressed concern that the exclusive list of grounds for setting aside an award would not cover all cases of procedural injustice. In its written comments, reproduced in A/CN.9/263/Add.2 (p. 9, para. 32), his Government had given some examples of that. The concept of public policy, mentioned in paragraph (2) (b) (ii), did not exist in his country and he could not say whether in other countries it would cover the examples he had mentioned. His delegation would welcome the addition to the article of a more general formula to ensure the possibility of recourse in all cases of serious procedural injustice.

5. Mr. MTANGO (United Republic of Tanzania) said that the list of grounds for setting aside an award should not be enumerated exhaustively; some flexibility should exist in that respect.

6. Mr. BROCHES (Observer for the International Council for Commercial Arbitration), referring to paragraph (2) (a) (i), said that the incapacity of only one of the parties should be sufficient reason for setting aside the award. The phrase "under the law applicable to them" was not clear; it would be preferable to state that the parties lacked the capacity to conclude an agreement. Although the present wording followed that of the 1958 New York Convention, the Commission might wish to depart from the Convention where its meaning was not clear.

7. Mr. SEKHON (India) agreed with the United Kingdom representative that the grounds given in article 34 (2) did not cover all possible cases. The Commission might, for instance, wish to include a provision covering misconduct of the arbitrator; if so, he could suggest suitable wording from his country's Arbitration Act. The question of public policy was a delicate one: it might, for example, be the public policy of a State with a considerable foreign debt to prohibit payments from being made to creditors in foreign countries, including payments owed under international commercial arbitration awards.

8. Mr. SAMI (Iraq) agreed with the Observer for ICCA that the phrase "under the law applicable to them" was vague.

The rule governing party incapacity should make it absolutely clear that the incapacity should exist at the time when the arbitration agreement was concluded, not afterwards.

9. Mr. PELICHET (Observer for The Hague Conference on Private International Law) endorsed the remarks of the Observer for ICCA. He drew attention to his organization's comments on article 36 (1) (a) (i), reproduced in A/CN.9/263/Add.1 (p. 22, para. 3), which applied to the second part of article 34 (2) (a) (i) as well. It did not seem right that the question of the validity of the arbitration agreement should be submitted to the law of the country of arbitration, since many arbitration proceedings were held in a country which had no connection with the main contract or the parties to it. Under most systems of private international law, validity of an arbitration agreement was decided by the law governing the main contract. He therefore proposed that the second part of article 34 (2) (a) (i) should be amended to read "or the said agreement is not valid; or ...".

10. Mr. MOELLER (Observer for Finland) agreed with previous speakers that the phrase "under the law applicable to them" should be amended. As to the proposal by the Observer for The Hague Conference, he thought the point was covered by the fact that the territorial scope of the Model Law allowed the parties complete freedom to choose the law applicable to their arbitration agreement.

11. Mr. LOEFMARK (Sweden) endorsed the comments of the Observer for Finland.

12. Mr. SZURSKI (Observer for Poland) agreed with other speakers that the words "under the law applicable to them" were unclear and should be amended in the manner suggested by the Observer for ICCA. Also, it was right that the incapacity of only one of the parties should be a sufficient ground for setting aside the award, and paragraph (2) (a) (i) should be amended to provide for that.

13. Mr. GRIFFITH (Australia) expressed approval of the changes recommended by previous speakers.

14. Mr. JOKO-SMART (Sierra Leone) said that he agreed with the United Kingdom and Tanzanian representatives that the grounds for setting aside an arbitral award should not be specified too rigidly. Also, the present text of article 34 (2) (a) (i) implied that the applicant should furnish proof that both parties were under some incapacity; surely it would be preferable for the applicant to furnish proof of its own incapacity only.

15. Mr. ROEHRICH (France) endorsed the comments of the Observers for ICCA and The Hague Conference.

16. Mr. de HOYOS GUTIERREZ (Cuba) said that the contents of paragraph (2) (a) (i) referred back to the words "the party making the application furnishes proof that ...". The best way of meeting the view expressed by a number of speakers, namely that the incapacity of only one party should be sufficient reason for setting the award aside, would be to formulate the provision in the singular. Criticism had been directed against the exhaustive nature of the present list of

reasons for setting aside an arbitral award. There were two possibilities for remedying the situation: to add new grounds, which might entail the risk of making the list too long, or, which he would prefer, to add a general provision, such as "for any other cause", which would not preclude the grounds which the list already mentioned and would allow for new reasons as well.

17. The CHAIRMAN observed that most countries would find it difficult to accept an open list since their legislation provided for exhaustive lists.

18. Mr. MTANGO (United Republic of Tanzania) supported the suggestion that paragraph (2) (a) (i) should be formulated in the singular. The article was well drafted otherwise and was consistent with the New York Convention and the 1961 European Convention, as well as with article 36 of the draft text. He therefore had doubts about the wisdom of accepting the other suggestions for altering it. Could the secretariat explain why the provision had been drafted as it had?

19. Mr. HERRMANN (International Trade Law Branch) said that an earlier draft of the provision had been almost identical with what the Observer for ICCA had just recommended, but the Working Group had decided to use the wording of the 1958 New York Convention instead because that had enabled article 34 to be aligned with article 36. It was true, of course, that the effects were not the same under the two articles. Under the Model Law and the 1958 New York Convention, an award could not be enforced in any other country once it had been set aside.

20. The CHAIRMAN asked the Observer for ICCA whether his recommendation that paragraph (2) (a) (i) should refer to the incapacity of only one party meant that the applicant should be able to furnish proof of the incapacity of either party. Some speakers had in mind the idea that only the incapacity of the applicant should be provided for.

21. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that his recommendation was that the applicant should be able to furnish proof of the incapacity of either party.

22. Mr. BARRERA GRAF (Mexico) said that the list of reasons for setting aside an arbitral award should be an exhaustive one. He agreed with the representative of the United Kingdom that the present list was inadequate and should be expanded. He also agreed with the recommendation of the Observer for ICCA about the applicant being able to furnish proof of the incapacity of either party. A further point was that subparagraph (a) (i) dealt with two separate matters, incapacity of the parties and invalidity of the agreement, which involved different principles of private international law. He suggested that they should be placed in separate provisions. As far as the latter subject was concerned, the existing formulation seemed too general.

23. Mr. VOLKEN (Observer for Switzerland) said that if the incapacity of a party to the arbitration agreement was proved, the agreement itself would be invalid. That suggested that subparagraph (a) (i) need not deal with the question of party incapacity at all. He did not feel that the time was ripe for altering the reference to the applicable law. It was true that the content of paragraph 2 was the result of efforts to achieve a parallel between articles 34 and 36. He had serious doubts whether such a parallel was both desirable and feasible. The main reason for setting aside an arbitration award should rest in the idea of manifest injustice.

24. Mr. HOELLERING (United States of America) said that he supported the ICCA recommendation but not The Hague Conference proposal.

25. Mr. BONELL (Italy) said that he too supported the ICCA recommendation. He understood the reason for The Hague Conference proposal but preferred the text to remain as it was in that respect; in the first place, it should as far as possible be in line with the New York Convention and, more important, no decision had yet been reached on the question of the law which should govern the arbitration agreement. If the Commission decided to delete the reference to two systems of law, it should do so in article 36 as well.

26. Mr. JARVIN (Observer for the International Chamber of Commerce) also supported the ICCA recommendation. He could not accept The Hague Conference proposal without further discussion.

27. Mrs. RATIB (Egypt) said that a party should not be able to lodge an objection under article 34 that had already been presented under article 8 or article 16.

28. Mr. ABOUL-ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) said that he supported the ICCA recommendation. He also favoured the idea that the reference to the law applicable should be changed. The proposal by The Hague Conference certainly needed careful study before there could be any thought of adopting it.

29. Mr. BOGGIANO (Observer for Argentina) supported the ICCA recommendation and the proposal of The Hague Conference but suggested that the latter should be discussed further in connection with article 36.

30. Mr. LEBEDEV (Union of Soviet Socialist Republics) asked for confirmation that acceptance of the ICCA recommendation concerning the words "the parties" was purely a drafting matter and would not imply that the Model Law and the New York Convention differed on that point substantively.

31. The CHAIRMAN said that the secretariat confirmed that.

32. Mr. SZASZ (Hungary) said that it was important to develop a system of international commercial arbitration but also important to ensure consistency between the various instruments governing the subject, particularly in order to help the user. If it was absolutely essential for the Commission to depart from the wording of documents such as the New York Convention, it should do so and explain its reasons in the report, but it should not make changes of that kind for purely cosmetic reasons.

33. Mr. STALEV (Observer for Bulgaria), supported by Mr. TANG Houzhi (China), endorsed the statement of the Hungarian representative.

34. Mr. MTANGO (United Republic of Tanzania) said that where the Model Law agreed word for word with the text of an existing international convention which was working well in practice, the Commission should only change it if it was unanimous about the need to do so.

35. The CHAIRMAN said it should be borne in mind that the 1958 New York Convention did not deal with the setting aside of awards.

36. Sir Michael MUSTILL (United Kingdom), while agreeing with the representative of Hungary, said that it would be wrong to incorporate wording from the 1958 New York Convention into the Model Law blindly.

37. Turning to paragraph (2) (a) (ii), he said that the textual distinction which existed between that provision and article 19 (3) was unnecessary. The two texts should be assimilated to each other.

38. Mr. HOLTZMANN (United States of America) said that he was inclined to agree. Making the change in the text of paragraph (2) (a) (ii) would of course bring the Model Law into line with the UNCITRAL Arbitration Rules but would at the same time distance it from the New York Convention.

39. Mr. SAMI (Iraq) said that the meaning of the words "or was otherwise unable to present his case" was unclear. There might be many reasons why a party was unable to present his case, but if they were personal ones or if the party could have avoided the situation, he should not be given an opportunity to have the award set aside.

40. The CHAIRMAN suggested that the Commission's report should make that point clear.

41. In response to drafting points raised by Mrs. RATIB (Egypt), Mr. SEKHON (India) and Mr. JARVIN (Observer for the International Chamber of Commerce), he suggested that the report should include a general statement to the effect that the Commission had had no wish to depart from the substance of the 1958 New York Convention but had felt compelled on occasion to adopt a slightly different wording for the Model Law. States could then decide whether to follow one or the other.

42. Mr. GRAHAM (Observer for Canada) suggested that paragraph (2) (a) (ii) was the place to take into account the comments of the United Kingdom about the need for paragraph (2) to cover all cases of serious procedural injustice. Three of the instances of that mentioned by the United Kingdom in its written observations (A/CN.9/263/Add.2, para. 32) related to lack of opportunity to present a case. He agreed with the United Kingdom representative that subparagraph (a) (ii) needed to be assimilated to article 19 (3), since procedural misconduct by the arbitrators interfered with the right of the parties to present their case. The problem might be overcome by redrafting it.

43. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) said that the text of paragraph (2) (a) (iii), which followed that of the 1958 New York Convention, was unclear and perhaps redundant.

44. Mr. STALEV (Observer for Bulgaria) said that it was necessary to consider the implications of article 16 (2) with respect to the procedures for setting aside and for the recognition and enforcement of arbitral awards. He suggested that article 16 (2) should be amended to make it clear that the

precluding of the parties from raising a plea of lack of jurisdiction twice applied not only to the arbitration proceedings but also to the procedures for setting aside and for the recognition and enforcement of awards.

45. Mr. BONELLI (Italy) said that the matter should be dealt with outside the Model Law by national legislators.

46. Mr. HOLTZMANN (United States of America) said that his delegation had always assumed that if a waiver with respect to jurisdiction or the scope of application of an award had not been raised during the arbitration proceedings, those issues could not be raised for the first time by the losing party in proceedings under article 34.

47. Mr. ROEHRICH (France) said that his delegation had the contrary understanding. It would be wiser to leave the present text as it was.

48. Mr. SAMI (Iraq) and Mr. SEKHON (India) endorsed the comments made by the representative of France.

49. Mr. GRAHAM (Observer for Canada) requested the secretariat to clarify the meaning of the last part of paragraph (2) (a) (iv), beginning with the words "failing such agreement".

50. The CHAIRMAN said that his own view was that if the parties had agreed on a matter not in conflict with the mandatory provisions of the Model Law and the arbitration procedure had run counter to that agreement, there would be grounds for setting the award aside. If, however, there had been no such agreement, the procedure must follow even the non-mandatory rules of the country in which it was sought to set the award aside, and there might be grounds for setting it aside if those rules had not been observed.

51. Mr. HERRMANN (International Trade Law Branch) said that the meaning of the wording in question, which appeared in the 1958 New York Convention and in article 36 as well, was disputed. The Working Group had taken the view that, for the purposes of article 34, it should be interpreted as meaning that an agreement between the parties which was in conflict with the mandatory provisions of the Model Law should not be used as the standard against which the conduct of the arbitration proceedings should be measured.

52. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) noted that subparagraph (a) (iv) provided that if an agreement conflicted with the mandatory provisions of the Model Law, non-observance of the agreement was not a ground for setting the award aside. It did not say that observance of such an agreement was a ground for setting it aside. The subparagraph would better reflect the Working Group's intention if the words "unless such agreement was in conflict with a provision of this Law" were replaced by the words "or the provisions of this Law".

The meeting rose at 12.40 p.m.

318th Meeting

Tuesday, 11 June 1985, at 2 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 2.10 p.m.

International commercial arbitration (*continued*)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264)

Article 34. Application for setting aside as exclusive recourse against arbitral award (*continued*)

Article 34 (2) (b) (i)

1. Mr. PELICHET (Observer for the The Hague Conference on Private International Law) said that subparagraph (b) (i) was completely unacceptable and might even be dangerous as it could permit a party to an arbitration agreement to have an award set aside in any State and thereby contradicted the principle that, in the absence of a choice by the parties, the law governing the substance of the dispute was the one which was applied to the question of arbitrability. Although the Working Group had decided to retain subparagraph (b) (i) in article 34 (2), it had indicated that the issues involved were of great practical importance and required further study. After giving the subject due consideration, his organization proposed that the subparagraph should be deleted.

2. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that in its report, the Working Group had solicited the comments of Governments and organizations on the matter (A/CN.9/246, para. 137) but that very few had been received. He disagreed with the Observer for The Hague Conference that the provision would make it possible for an award to be set aside by a court in a State alien to the arbitration. The only country whose courts could be asked to set aside an award was the country whose law governed the arbitration; the courts of a third country could not set aside an award made outside their jurisdiction. That was why he believed that subparagraph (b) (i) should be left as it was.

3. Mr. LOEFMARCK (Sweden) said that he agreed with the Observer for The Hague Conference and believed the subparagraph should be deleted. It was disturbing that the question of whether an award was in conflict with public policy could be settled by a court only if the parties so requested. A court located in the country where enforcement was sought ought to be able to take a decision of its own motion and not only at the request of a party.

4. Mrs. RATIB (Egypt) supported the proposal to delete the subparagraph. If it was deleted, the issue of setting aside an award would still be covered by subparagraph (b) (ii), where the issue of arbitrability related to public policy, and by subparagraph (a) (i), where it was connected with the validity of an arbitration agreement.

5. Mr. MOELLER (Observer for Finland) said that his delegation favoured the deletion of subparagraph (b) (i) for the reasons given by the Observer for The Hague Conference. In some States, arbitration might be restricted by local peculiarities unknown in other countries.

6. Mr. STROHBACH (German Democratic Republic) said that he shared the view of the representative of the International Council for Commercial Arbitration and would prefer subparagraph (b) (i) to be retained. The difficulties which might arise in connection with that provision could be

avoided if the parties chose as their place of arbitration a country in which the particular dispute could be settled by arbitration.

7. Sir Michael MUSTILL (United Kingdom) said that his delegation had no strong views on the subject but recalled that in accordance with a decision taken at the initiative of the Soviet Union, a provision would be included in article 1 to stipulate that the Model Law would be overruled by any local law governing the arbitrability of certain matters. Any attempt to arbitrate under the Model Law would accordingly be illegitimate if, under the law of the State in question, the subject-matter was not arbitrable. With regard to the suggestion that the parties themselves should solve the problem of the place of arbitration, he recalled that the Working Group's discussion had produced a sharp distinction in the text between subparagraph (a), which was to be invoked only if the party making the application furnished proof, and subparagraph (b), under which the court could take up a matter on its own motion. It was for that very reason that subparagraph (b) (i) had been placed in article 34 (2) (b) rather than article 34 (2) (a).

8. The CHAIRMAN said that an arbitral award could be set aside only if a party so requested; the court did not have the power to make such a ruling of itself.

9. Mr. SZASZ (Hungary) said that although a State might decide not to allow certain types of claims to be settled by arbitration, a party relying on the law of that State should not be denied the right to have an award set aside. He would prefer the subparagraph to be retained.

10. Mr. ROEHRICH (France) said that, for the reasons advanced by the Observer for The Hague Conference, his delegation favoured the deletion of subparagraph (b) (i) and believed that if it was deleted, subparagraph (b) (ii) should be deleted as well. He did not deny that the questions of arbitrability and public policy were extremely important, but they would be dealt with under article 36.

11. The CHAIRMAN suggested a compromise solution of deleting the phrase "under the law of this State". That would leave open the question of whether the law of a given State or international law would apply. It must be understood, however, that in most cases a State would apply its own law.

12. Mr. PELICHET (Observer for The Hague Conference on Private International Law) said that he could fully support the Chairman's compromise solution.

13. Mr. GRIFFITH (Australia) said that he concurred with the delegation of Hungary. The subparagraph should be retained; the matter should not be covered exclusively under article 36.

14. Mr. SEKHON (India) said that for the reasons advanced by the representative of Hungary, his delegation would favour the retention of the subparagraph.

15. Mr. SZASZ (Hungary) said that his delegation had no objection to the Chairman's compromise solution, particularly

as it believed the deletion of the phrase in question would not substantially change the meaning of the subparagraph.

16. Mr. HOELLERING (United States of America) said that he endorsed the text as it stood and did not favour the compromise solution because it would create confusion and uncertainty.

17. Mr. ABOUL-ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) supported the deletion of subparagraph (b) (i) but preferred subparagraph (b) (ii) to be retained.

18. Mr. de HOYOS GUTIERREZ (Cuba) said that he supported the Chairman's suggestion to delete the closing phrase because that phrase was too restrictive.

19. Mr. LAVINA (Philippines) shared the views expressed by the representative of Hungary and urged the retention of the subparagraph as it stood.

20. Mr. BOGGIANO (Observer for Argentina) said that, as he understood it, the phrase "under the law of this State" referred to substantive law. If a State wished to apply the law of another country, it should be free to do so and not be forced to apply its own law. He endorsed the comments made by the Observer for The Hague Conference but found acceptable the Chairman's suggestion, which would leave it to the court to decide which law was applicable.

21. Mr. MTANGO (United Republic of Tanzania) said that he favoured the retention of both subparagraphs (b) (i) and (b) (ii).

22. Sir Michael MUSTILL (United Kingdom) said that he believed the subparagraph was of extremely limited practical importance; nevertheless, he endorsed the views expressed by the representative of Hungary and opposed the Chairman's suggestion, which would obscure the meaning of the subparagraph.

23. Mr. SAWADA (Japan) said that he supported the retention of the subparagraph.

24. Mr. BONELL (Italy) said that his first preference would be the retention of the subparagraph unaltered but that he could accept the Chairman's suggestion.

25. Mr. VOLKEN (Observer for Switzerland) said that he favoured the deletion of the subparagraph but could accept the Chairman's compromise solution. He would be interested to know, from those delegations which favoured its retention, whether in the case of (2) (b), under their countries' legislation, a court could set aside an award of its own motion. There was a curious dichotomy in the text between paragraphs (2) (a) and (2) (b), in other words, between the party making an application and the court acting on its own motion; moreover, the procedure for setting aside an award under article 34 was not compatible with the procedure for recognition and enforcement under article 36. The provisions of subparagraph (b) (ii) would have great merit in a procedure on recognition and enforcement, but not in an action on the setting aside.

26. Mr. SCHUMACHER (Federal Republic of Germany) said that he favoured the retention of subparagraph (b) (i) and thought that the compromise proposal left the most important question wide open and could create more problems than it solved.

27. Mr. TANG Houzhi (China) said that even though the compromise solution might cause some problems, it was the most reasonable and practical of the available approaches, and his delegation supported it.

28. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that he endorsed the Chairman's suggestion.

29. Mr. ROEHRICH (France) said that he too could accept the Chairman's suggestion.

30. Mr. GRAHAM (Observer for Canada) said that the Chairman's suggestion was a reasonable one, which would allow States to decide whether they wanted arbitration to be delocalized.

31. Mr. HOLTZMANN (United States of America) said that in his delegation's view, the "compromise" solution was in fact the most radical one. When parties sat down to draft a contract, they needed to know whether local laws of the place of arbitration permitted arbitration of the kinds of dispute that might arise. The Model Law should enable the parties to know in advance under what conditions arbitration might take place, but the Chairman's suggestion would have the effect of leaving them entirely in the dark on that point. This compromise could lead parties to choose arbitration where there was certainty rather than in less-developed legal systems.

32. The CHAIRMAN suggested that, as most delegations seemed to favour the retention of subparagraph (b) (i), the text should be left unaltered.

33. *It was so agreed.*

Article 34 (2) (b) (ii)

34. Mr. SEKHON (India) said that his delegation would prefer to see subparagraph (b) (ii) deleted. The expression "public policy" was much too vague and had very little to do with the law of arbitration. If the subparagraph were retained, the Commission should consider deleting the phrase "or any decision contained therein", which was superfluous as the whole necessarily included all of its parts, and a decision was part of an award.

35. Mr. LOEFMARCK (Sweden) said that his delegation would prefer the subparagraph to be deleted but would not insist upon it.

36. Mrs. VILUS (Yugoslavia) said that she agreed with the comments of the representative of India. The subparagraph could be interpreted to mean that an award could be set aside because "a decision contained therein", i.e. a part of that award, conflicted with certain principles of the law of the forum which were irrelevant to the merits of the case. The subparagraph was not, moreover, compatible with a restrictive interpretation of the notion of public policy.

37. Mr. SAMI (Iraq) said that his delegation also felt that the phrase "in conflict with the public policy of this State" was very ambiguous. He would prefer a wording such as "in conflict with the legal order of this State". If the wording was not changed, he would prefer the subparagraph to be deleted.

38. The CHAIRMAN said that "public policy" was a translation of the French term "*ordre public*" and meant the fundamental principles of law.

39. Mr. OLUKOLU (Nigeria) also felt that subparagraph (b) (i) should be deleted. The term "public policy" was too vague to provide the guidance that the countries applying it should be able to expect from the Model Law.

40. Mr. JARVIN (Observer for the International Chamber of Commerce) thought that the idea of public policy was perhaps vague. It should, however, be further developed in the Model Law and a distinction made between international and national public policy. The Model Law was intended to apply to international trade.

41. Sir Michael MUSTILL (United Kingdom) pointed out that the term "public policy" was used again in article 36 (1) (b) (ii). In his delegation's view, the question was linked with the general problem of whether there should be a general provision encompassing all cases of serious procedural injustice. It was important to know, therefore, whether a case of serious procedural injustice would be regarded as contrary to public policy. If the term would allow the court to intervene in such cases, his delegation would regret the deletion of the subparagraph. If the subparagraph was not concerned with such cases, he would not object to its deletion.

42. The CHAIRMAN said that during the drafting of the 1972 European Convention on State Immunity, subsequently ratified by both the United Kingdom and Austria, there had been a long discussion on "*ordre public*". Ultimately, the French text of the Convention had used simply "*ordre public*", while the English text had had to specify a violation of a fundamental rule of procedure in the form of "no adequate opportunity fairly to present his case". That language had been used to make it clear that the notion was not limited to substantive law.

43. Mr. ROEHRICH (France) said that he felt the same concern as the United Kingdom representative. He had said earlier that his delegation would have no objection to the deletion of subparagraph (b) (ii). However, since a discussion had arisen on an addition to the provision in order to meet the anxiety of the common law States, an approach must be found which would cover the notion expressed in the 1972 European Convention on State Immunity. A formula was needed that would be acceptable to all States, irrespective of their legal systems. His delegation favoured retaining the subparagraph, provided it could be reworded to deal with those anxieties.

44. Mr. GOH (Singapore) was in favour of deleting the subparagraph. He felt that its retention would allow the court to intervene in matters which the parties had agreed to submit to arbitration.

45. The CHAIRMAN thought that subparagraph (b) (ii) was the best place for an improved explanation of the idea. The problem raised by the United Kingdom delegation could be solved by using different wording, because the intention was to refer to deviations from the fundamental principles of the law "of this State", both substantive and procedural. There was a public policy clause in all 38 conventions of The Hague Conference. He urged the Commission not to delete the subparagraph simply because the notion of "public policy" was strange, but rather to find a more comprehensive formula which would meet the fears of the United Kingdom and other delegations.

46. Mr. BONELL (Italy) said that the purpose of the subparagraph was to make it clear that, in addition to the reasons set out in the preceding subparagraphs, there was a more general limitation beyond which an award could not go.

He pointed out that there was no other possibility of supervising the content of the award. If subparagraph (b) (ii) was deleted, there were two possibilities: either the matter would be left entirely open and the recognition of any kind of award would be allowed, or the possibility would be hinted at that not only general but less than general principles were at stake, which would be an undesirable result. The aim was to provide for a minimum of court control and supervision. If a clearer form of words could be suggested, his delegation would welcome it. He noted that the 1958 New York Convention used the same concept (article V, para. 2 (b)). That Convention had worked satisfactorily so far.

47. Mr. BOGGIANO (Observer for Argentina) felt that it would be inconsistent to retain subparagraph (b) (i) and to reject (b) (ii). His delegation considered that "*ordre public*" constituted a body of fundamental principles which included also due process of law. The subparagraph implied a guarantee of protection against serious procedural injustice in the arbitration proceedings.

48. Mr. HOELLERING (United States of America) was in favour of retaining the subparagraph as it stood. To delete it would be a radical departure from the New York Convention. It was a concept frequently used in the United Nations, and its retention would enhance the acceptability of the Model Law. He was certain that the concern of the United Kingdom could be met by means of drafting changes.

49. Mr. TORNARITIS (Cyprus) thought that the subparagraph should not be deleted simply on account of its use of the term "public policy". If a more appropriate term could be found, his delegation would have no objection to the subparagraph. He noted that the words "*ordre public*" had been used in the English text of the Fourth Protocol to the European Convention on the Protection of Human Rights.

50. Mr. MTANGO (United Republic of Tanzania) said it was inaccurate to say that the concept of public policy was unknown in some common law States. It was in familiar use in contract law, for example. He had heard the concept defined as "binding rules of the legal system". He was in favour of retaining the subparagraph, with the deletion of the phrase "or any decision contained therein" if the Commission so decided.

51. Mr. GRAHAM (Observer for Canada) sympathized with the Indian position but favoured retaining the reservation contained in the subparagraph. In Canada, the common law and the civil law systems were both present, and problems such as that under discussion had had to be faced. He associated himself with the United States position on the subparagraph. The concept of public policy (*ordre public*) was included in many international conventions, and deleting it from the Model Law would be tantamount to refusing to tolerate the civil law concept. It might be possible to include a further subparagraph in paragraph (2) to accommodate the suggestion of respect for procedural regularity. He felt, however, that it would be better to expand the notion in paragraph (2) (b) (ii) along the lines of article 20 (2) (a) of the European Convention on State Immunity.

52. Mr. de HOYOS GUTIERREZ (Cuba) favoured maintaining subparagraph (b) (ii).

53. Mr. MATHANJUKI (Kenya) also favoured retaining the subparagraph. His delegation appreciated the need to provide for a rule of general character which would cover serious misjustice to the detriment of one of the parties to the arbitration. His delegation would not insist on the term

"public policy" but would accept any form of words that reflected the seriousness with which procedural injustice was regarded in the Model Law.

54. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) said that the notion of public policy was fundamental to her country's legal system. Her delegation was therefore in favour of retaining the subparagraph.

55. Mr. JOKO-SMART (Sierra Leone) said that, before the debate, his delegation had been in favour of retaining the subparagraph because of its understanding of the meaning of "public policy". There now seemed to be some confusion as to whether "*ordre public*" was properly rendered by the term "public policy", and unless that term was clarified, his delegation would be in favour of deleting the subparagraph.

56. The CHAIRMAN said that the Commission seemed disposed to retain the reference in article 34 (2) (b) (ii) to public policy without amplification in the text, but with a reference in the report to what the term meant in other conventions in which it was used, namely fundamental principles of law, without differentiating between substantive and procedural law. On the other hand, several speakers had supported the deletion of the phrase "or any decision contained therein". He took it there was agreement to delete it.

57. *It was so agreed.*

58. The CHAIRMAN, reverting to the issue which the United Kingdom delegation had raised in respect of subparagraph (a) (ii) of article 34 (2), said that perhaps the subparagraph could be widened a little so as to cover procedural irregularities. He suggested that the United Kingdom representative might submit a draft amendment for consideration by the Commission.

59. Mr. TORNARITIS (Cyprus) said that he agreed that public policy meant the general principles of law, both procedural and substantive.

60. Mr. LOEFMARCK (Sweden) said he agreed that there should be no attempt to define "public policy" in the text of paragraph (2) (b) (ii). With regard to paragraph (2) (a), he was in favour of adding something about errors of procedure which had affected the outcome of the case, such as false evidence. He also felt that provision should be made for the possibility of new grounds for challenging an arbitrator which became known between the announcement of the award and the application for setting it aside. That aspect was not covered by paragraph (2) (a) (iv). He had no objection to an attempt being made to meet his point by an amendment to paragraph (2) (a) (ii), although it did not concern an error of procedure.

61. Mr. HOELLERING (United States of America) said his delegation also did not favour the insertion of a definition of public policy in paragraph (2) (b) (ii). As to a possible amendment to paragraph (2) (a) (ii), he thought it should not be so broad as to include mistakes by arbitrators, mistakes of fact of any kind or newly discovered evidence, but should be restricted to situations where the award was procured by fraud, corruption or undue means.

62. Mr. ROEHRICH (France) said he understood that the Swedish proposal referred only to grounds for a challenge discovered after the handing down of the award. Otherwise, paragraph (2) (a) (iv) would apply. If the Swedish proposal implied the creation of new grounds for setting aside the

award, he would have serious objections to its introduction into article 34. In connection with the suggested United Kingdom addition to paragraph (2) (a) (ii) to deal with relatively exceptional cases, an attempt should be made to find a wording which was not too precise. It should concentrate on violations of the fundamental principles of procedure or failure to respect the legitimate expectations of parties with regard to the proper conduct of arbitration proceedings and not on the non-observance of ordinary procedural rules.

63. Sir Michael MUSTILL (United Kingdom) said that for the purposes of drafting an addition to paragraph (2) (a) (ii), it was essential to know the decision of the Commission on a point which had not yet been discussed and which had been raised in the comments of the Swedish Government on paragraph (2) (a) (A/CN.9/263, p. 47, para. 8). Briefly, it was whether the right to set aside an award existed whenever the facts set out in article 34 (2) (a) were proved or only if those facts had affected the result of the arbitration. Some countries believed that if a procedural injustice was proved, it was improper to allow an award to stand. Others took the view that the award should stand if the procedural injustice had made no difference. The Commission's decision on that point would have a bearing on whether or not the formulation should be along the lines of "if in any other case, there has been a substantial procedural injustice materially affecting the award".

64. Mr. ROEHRICH (France) said his delegation would prefer to have some objective elements which implicitly involved the principle of a party's motive to act. It would be very difficult to draft a definition of the concept of affecting the content of an award, in view of differences in legal systems. Once it was determined relatively clearly that the fundamental principles of procedure had been breached, there was no need to state as a further condition that it must be proved in each case that the award had been materially affected.

65. Mr. SZASZ (Hungary) said he agreed with the French representative's comments. The Commission should not go further than the present well-balanced texts in which the use of the word "may" in the opening sentence of paragraph (2) covered all the necessary elements. The court would look at the nature of the reason for setting aside an award.

66. Mr. BONELL (Italy) said that he too was in favour of leaving the text of paragraph (2) as it stood. However, he considered that the Commission should have a discussion on the point raised by the United Kingdom and Swedish representatives, a point which also appeared in the Italian comments on paragraph (2) (a) (A/CN.9/263, p. 47, para. 8). It concerned the possibility that the arbitration procedure had not functioned properly in the broadest sense. If the Commission was to pay attention to that quite separate issue, there should be no attempt to include it among grounds for setting aside the award, which related only to formal errors in the arbitration proceedings. It should be dealt with separately, and it should be made clear that, in addition to the present setting-aside procedure, there might in exceptional cases be other, non-technical grounds for putting aside an award. He agreed that those additional grounds should be relevant only to the extent that they had affected the outcome of the arbitration procedure. The United Kingdom representative appeared to have been given a mandate to prepare a draft on an issue which had not so far been discussed. Apart from the problem of how to deal with that issue, there would also be the matter of the time-limit specified in paragraph (3), which would not work for such cases.

67. Mr. LOEFMARCK (Sweden) said that his proposal had really been concerned with errors of procedure which had affected the outcome of the award. He agreed with the Italian representative that they were different from the other procedural grounds and should be dealt with in a separate subparagraph. He urged the United Kingdom representative to provide a draft in that sense.

68. Mr. SZASZ (Hungary) said that further discussion should be deferred until the Commission had a draft text before it. However, as far as the United Kingdom draft was concerned, he would draw attention to the fact that the four cases given in the United Kingdom comments (A/CN.9/263/Add.2, p. 9) did not necessarily fall under the notion of procedural injustice. They were not interrelated and could not easily be covered by a single formula. More analysis was required.

69. Sir Michael MUSTILL (United Kingdom) said that the comments of the Hungarian representative were well taken. The examples were the result of a challenge to the United Kingdom delegation to produce instances in which it would be desirable to have court intervention and which were not covered in article 34. The examples it had given were not all procedural and not all of the same kind, nor was the list exhaustive. The Commission had not considered at all whether matters outside the field of strict procedural injustice should be grounds for court intervention. He regarded his drafting mandate as confined to the precise subject of the discussion. He could not draft a formulation to cover the four examples in the United Kingdom comments without further guidance from the Commission.

70. The CHAIRMAN observed that some of those examples would be covered by the reference to public policy.

71. Mr. MTANGO (United Republic of Tanzania) said that the United Kingdom list of examples was not exhaustive; there were other reasons for setting aside an award which should also be taken into account. The Commission should not close its discussion on the issue.

72. The CHAIRMAN suggested that when the United Kingdom representative had produced a draft, the Commission should consider whether it was adequate or whether a more general clause was needed.

73. *It was so agreed.*

Article 34 (3)

74. Mr. NEMOTO (Observer for the Asian-African Legal Consultative Committee) said that the period of three months was rather long. He therefore suggested the insertion of the phrase "unless the parties have agreed to limit that period".

75. Mr. MTANGO (United Republic of Tanzania) thought that the period of three months was too short. Perhaps the compromise would be to leave it without qualification.

76. The CHAIRMAN observed that it would be difficult for parties to impose a time-limit on judicial procedure.

Article 34 (4)

77. Mr. STROHBACH (German Democratic Republic) said that the rule in paragraph (4) seemed rather strange but his delegation could accept it subject to further clarification. The provision should state expressly whether the arbitrators were entitled to make a new award or some substantial amendment to the original award, which remained binding and final. It was perhaps only a matter of drafting.

78. Mr. ROEHRICH (France) supported the Austrian proposal to delete paragraph (4) (A/CN.9/263, p. 48, para. 15). The procedure was indeed strange and postulated a concept of the relationship between the arbitral tribunal and State jurisdiction which it was difficult for his delegation to accept. It was not merely a matter of drafting or clarification. He feared the procedure was not likely to prove useful. Each body should perform its proper function. Once the award was made, there should be a certain control which was essential to ensure that justice was observed, but comings and goings between the arbitral tribunal and the court were not desirable and could only be prejudicial to the whole concept of arbitration.

79. Mr. SAMI (Iraq) endorsed the observations of the French representative. The procedure was unnecessary and he failed to see in what cases it would be usefully applied.

80. Mr. MOELLER (Observer for Finland) said that the procedure of "remission" appeared strange to the Finnish legal system but it was known in some common law countries. He therefore associated himself with the request of the representative of the German Democratic Republic. The procedure might be useful and the paragraph should not merely be deleted.

The meeting rose at 5.05 p.m.

319th Meeting

Wednesday, 12 June 1985, at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 9.40 a.m.

International commercial arbitration (continued)

(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264; A/CN.9/XVIII/CRP.1 and 3-6)

*Article 34. Application for setting aside as exclusive recourse against arbitral award (continued)**Article 34 (4) (continued)*

1. Mr. SAWADA (Japan) said that the paragraph was an unknown quantity. That was not a reason for its deletion, but it would help his delegation to make up its mind about the provision if the secretariat could explain how it would work.

2. Mr. HERRMANN (International Trade Law Branch) said that the aim of paragraph (4) was to give the court the option of not setting aside the arbitral award when there was a possibility of curing the defect in the arbitral proceedings. The question would be considered by the court referred to in article 6. The court would not, however, be able to invite the arbitrators to cure the defect in the case of some of the reasons for setting aside listed in article 34 (2), for example incapacity of a party or invalidity of the arbitration agreement. In some legal systems, once the arbitrators had made their award their mandate could not be revived, but paragraph (4) would empower the court to do that.

3. Sir Michael MUSTILL (United Kingdom) said that his delegation was strongly in favour of the principle expressed in paragraph (4). In the United Kingdom, remission had proved a very valuable remedy by avoiding the choice between completely quashing the award and allowing no relief at all. It was very rare in practice in the United Kingdom for an award to be set aside; when a court had to intervene, the less drastic remedy of remission was usually granted. His delegation supported the written suggestion of the International Bar Association, reproduced in A/CN.9/263 (p. 48, para. 18), that the paragraph should be formulated along the lines of the version given in paragraph 126 of A/CN.9/246.

4. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that from the viewpoint of arbitrators paragraph (4) was very valuable, and he was perturbed at the prospect of its deletion. The objections raised to the paragraph were not serious and concerned only the obscurity of the language and the novelty of the provision. The remission system already operated well in many countries and offered a better means of dealing with procedural defects or mistakes by the arbitrators than the alternative, which was the complete setting aside of the award.

5. Mr. SEKHON (India) said that his delegation was in favour of paragraph (4). The fact that such a provision was not found in some legal systems was not a reason for excluding it if it was meritorious. The aim, after all, was harmonization of law. He suggested that the words "an opportunity to resume the arbitral proceedings" should be replaced by the words "an opportunity to reconsider the arbitral proceedings".

6. Mr. STALEV (Observer for Bulgaria) proposed, as a compromise, that the closing portion of the paragraph should read "an opportunity to eliminate such grounds for setting

aside as are remediable without reopening of the arbitral proceedings". That would cover cases when, for example, the arbitrators had not given reasons for their award or had not all signed the award. The present text of the paragraph implied that the arbitrators would have the power to vacate the contested award, for otherwise a new award would not be possible; until the court set the contested award aside, if it did, the parties and the arbitrators would be bound by it. The arbitrators' power to vacate should therefore be stated explicitly, a point to some extent covered by the useful suggestion made by the German Democratic Republic (A/CN.9/SR.318, para. 77).

7. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that the Council was strongly in favour of paragraph (4), which would benefit both arbitrators and businessmen. He thought that the Bulgarian proposal would make the provision more generally acceptable.

8. Mr. JOKO-SMART (Sierra Leone) said that if the purpose of the paragraph was to empower the court to remit an award to the arbitrators, it would be better to delete the words "and so requested by a party", which cast doubt on whether the court had that power. The hands of the court should not be tied by the wishes of the parties.

9. Mr. GRIFFITH (Australia) said that paragraph (4) was a sensible and useful provision in its existing form. He endorsed the view of the Observer for the International Council for Commercial Arbitration that it would benefit arbitrators and businessmen. His delegation opposed the Bulgarian proposal.

10. Mr. ENAYAT (Observer for the Islamic Republic of Iran) said that his delegation was in favour of the provision, which would save the parties time and money in cases in which the court found there was a defect in the arbitral proceedings. The arbitrators' review of their award should, however, be for the purpose of curing defects in the award itself and should not result in the validation of an award in the making of which mandatory procedural rules had not been observed.

11. Mr. GRAHAM (Observer for Canada) endorsed the comments made by the representative of Australia.

12. Mr. HOLTZMANN (United States of America) said that his delegation could accept the paragraph as submitted by the Working Group on International Contract Practices even though the version suggested by the International Bar Association seemed marginally better. It opposed the Bulgarian proposal but liked the idea put forward by the representative of Sierra Leone.

13. Mr. JARVIN (Observer for the International Chamber of Commerce) said that he was in favour of the principle contained in paragraph (4) but thought the provision should be amended to provide that the court had the power to suspend the setting-aside proceedings of its own motion and not only at the request of a party.

14. Mr. GOH (Singapore), Mr. LAVINA (Philippines) and Mr. ABOL-ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) spoke in favour of the paragraph.

15. Mr. SZURSKI (Observer for Poland) said that his delegation supported the idea of including the paragraph in the Model Law but thought it would rarely need to be used in practice. It would be improved by various drafting changes, including the replacement of the words "grounds for setting aside" by "possible grounds for setting aside" or "grounds for setting aside indicated by the court". The remission procedure might of course cause problems for the arbitrators if they were located in another country, and it would increase the costs of the arbitral proceedings.

16. Mr. MTANGO (United Republic of Tanzania) said that he was not opposed to the inclusion of the paragraph in the Model Law. He wished to point out, however, that if the court had the power to order a resumption of the arbitral proceedings, the potential costs to the parties would be much higher. The parties should therefore have a say in any decision on remission.

17. Mr. SAWADA (Japan) said that his delegation felt strongly that the court should have the power to remit only at the request of a party.

18. Mr. MOELLER (Observer for Finland) said that even if the words "and so requested by a party" were deleted, the provision would still be understood in his country to mean that remission could only be ordered if requested by a party. The Commission might make the intention of the paragraph clearer by using a formula such as "the court, at the request of a party or of its own motion".

19. The CHAIRMAN said that in his opinion the words "when asked to set aside an award" covered that point.

20. Mr. VOLKEN (Observer for Switzerland), Mr. SCHUMACHER (Federal Republic of Germany) and Mr. OLUKOLU (Nigeria) expressed their agreement with the Japanese contention that the court should have power to remit only at the request of a party.

21. The CHAIRMAN said that it seemed to be the general view that the paragraph should be included in the Model Law and that the court should have the power to suspend the setting-aside proceedings only when so requested by a party. There appeared to be little support for the Bulgarian proposal. He suggested, therefore, that the substance of paragraph (4) should not be changed and that the various drafting suggestions which had been made should be submitted to the drafting committee.

22. *It was so agreed.*

Article 1. Scope of application (continued)

Article 1 (1) (continued)

23. Mr. HOLTZMANN (United States of America) introduced the text proposed by the *ad hoc* working party (A/CN.9/XVIII/CRP.1).

24. Mr. ROEHRICH (France) said that his delegation was not happy with the new proposal. Its main defect was that it no longer used the term "international commercial arbitration", which despite different interpretations had become a well-known concept in international trade circles. The new wording created ambiguity, especially by using the words "other economic relations". His delegation favoured a broad interpretation of the concept of "commercial" but was unwilling to exchange satisfactory wording for unsatisfactory. Any reference to "services and other economic relations" should appear in the footnote and not in the text.

25. Mr. WAGNER (German Democratic Republic) said that his delegation could accept either the original text or the new version. If the Commission adopted the latter, he would like to have the words "whether contractual or not" inserted after the words "economic relations". If the original text was retained, the insertion should come after the words "commercial nature" in the footnote.

26. Mrs. RATIB (Egypt) said that her delegation preferred the original text.

27. Sir Michael MUSTILL (United Kingdom) said that his delegation tended to prefer the original text. The new version introduced into the text two ideas taken from among a number of ideas expressed in the original footnote. It would be better for all those notions to be in the footnote since they were all of similar importance. He agreed with the representative of France that the term "international commercial arbitration" had become generally accepted.

28. Mr. SAMI (Iraq) said that his delegation also had problems with the new proposal. The original text should be retained and any necessary details defining commercial activity should appear in the footnote.

29. Mr. HOLTZMANN (United States of America) said that the *ad hoc* working party had inserted the phrase "economic relations" in the text of the paragraph with the intention of summarizing the contents of the original footnote. The word "services" was intended to reflect the majority's desire that they be included. He noted that the intention was to make clear that a contract to buy trousers, a contract to build a factory and a contract to lend money would all be "commercial" under the Model Law, even though they might not be under some laws.

30. Mr. SAWADA (Japan) said that his delegation preferred the original text. If the Commission decided to adopt the new version, the phrase "including services and other economic relations" should be replaced by the words "including those involving services", and the words "commercial matters" should be replaced by "commercial transactions".

31. Mr. ILLESCAS ORTIZ (Spain) agreed with the French representative with regard to the term "international commercial arbitration"; it was a *nomen juris* recognized in many countries and should appear in the Model Law. The reference to "services and other economic relations" should appear in the footnote.

32. Mr. LEBEDEV (Union of Soviet Socialist Republics), supported by Mr. SZASZ (Hungary) proposed that the original text should be maintained, with two minor amendments to the second footnote: the end of the first sentence should be amended to read "... relationships of a commercial nature, whether contractual or not", as suggested by the representative of the German Democratic Republic; and in the second sentence, the words "exchange of goods" should be amended to read "exchange of goods or services".

33. Mr. ABOUL-ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) said that he too preferred the original text of paragraph (1).

34. Mr. ROEHRICH (France) supported the proposed Soviet Union amendment with the exception of the addition of the words "whether contractual or not"; they were unnecessary, because the commercial nature of the transaction was the deciding factor.

35. Mr. TANG Houzhi (China) said that he found the Soviet Union proposal acceptable in its entirety. A further point was that it should be made clear that the paragraph was not intended to affect State immunity.

36. The CHAIRMAN suggested that the report on the session should make it clear that the Commission intended the Model Law to cover also parties other than strictly commercial parties but that it did not affect State immunity.

37. Mr. MTANGO (United Republic of Tanzania) expressed support for the Soviet Union proposal.

38. Mr. JARVIN (Observer for the International Chamber of Commerce) said that the footnote to the paragraph should make it clear that State enterprises could be considered commercial parties for the purposes of the Model Law. No such clarification existed in the text at present.

39. The CHAIRMAN noted that there was widespread support for the Soviet Union proposal. Unless there was any objection, he would take it that the Commission wished to adopt it.

40. *It was so agreed.*

Article 1 (2) (c) (continued) and proposed new paragraphs (4) and (5)

41. Mr. GRIFFITH (Australia), introducing the proposal in A/CN.9/XVIII/CRP.5, said that it attempted to reconcile the various views expressed in the Working Group on International Contract Practices and in the Commission. The proposed new paragraph (4) had been introduced as a *lex specialis* provision.

42. Mr. LEBEDEV (Union of Soviet Socialist Republics), explaining the proposed new paragraph (5), said that the Commission had agreed that a provision of national legislation forbidding arbitration on certain disputes should not be overruled by the Model Law. The text of the paragraph was an adaptation of article 1 (3) of the 1966 European Convention Providing a Uniform Law on Arbitration.

43. Mr. MTANGO (United Republic of Tanzania), referring to the proposed inclusion of the new paragraph (4), said that it should be left to States to decide whether the Model Law should overrule a national law.

44. Mr. BONELL (Italy) said that the proposal was acceptable. He understood the concern of the Tanzanian representative about the *lex specialis* provision and wished to point out that States could choose which provisions of the Model Law they would adopt.

45. Mr. SAWADA (Japan) said that the wording of the proposed paragraph (4) might be brought into line with that of the suggested paragraph (5) by amending the words "other provisions of law" to read "provisions of any other law". With regard to the proposal for paragraph (2) (c), his delegation wished to repeat the view it had expressed at the 307th meeting (A/CN.9/SR.307, para. 44) that it was not desirable that the decision about the internationality of an arbitration should lie with the parties.

46. Mrs. RATIB (Egypt) suggested that the proposed new paragraphs (4) and (5) should be amalgamated.

47. Mr. HOLTZMANN (United States of America), supported by Mr. LEBEDEV (Union of Soviet Socialist Republics), said that the *ad hoc* working party had decided that the matters dealt with in the two paragraphs involved different scopes of application and should therefore be treated in separate paragraphs.

48. Mr. KADI (Algeria) said that his delegation's only problem with the proposal concerned paragraph (4), about which he shared the Tanzanian representative's view. He suggested that the paragraph should be deleted.

49. Mr. BOGGIANO (Observer for Argentina) shared the view expressed by the representative of Japan about paragraph (2) (c), which represented a fundamental departure from the original text and would allow a dispute to be internationalized even if in reality it was connected with only one State.

50. Mr. LAVINA (Philippines) said that his delegation also felt that concern about paragraph (2) (c) and preferred the original version of the provision. A further point concerning the *ad hoc* working party's version of subparagraph (c) was that it used the word "country" instead of the normal term "State". He could not see the reason for that.

51. Mr. SZURSKI (Observer for Poland) said that he fully supported the position taken by Japan.

52. Mr. SCHUMACHER (Federal Republic of Germany) said that the content of the proposed paragraph (4) was not appropriate for a Model Law. However, if it was adopted it would conflict with paragraph (5) and would then need to contain the words "notwithstanding paragraph (5)".

53. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that he too had considerable doubts about paragraph (4). He had found no evidence in the summary record of any discussion which might justify the insertion of such a provision into the Model Law. It was true that at the 307th meeting (A/CN.9/SR.307, para. 57) the Commission had agreed that the United States written suggestion in A/CN.9/263 (p. 8, para. 3), namely that the Model Law should express the principle of *lex specialis*—a valuable idea—should be considered by the *ad hoc* working party in connection with the Soviet Union proposal about dispute arbitrability. His view of the principle of *lex specialis* was that in matters not governed by the Model Law, States should be free to include any provisions they wanted in the national law. The proposed paragraph (4), however, seemed to reverse that principle completely by making the Model Law override the provisions of national law. Moreover, it employed the controversial expression "matters governed by this law".

54. Sir Michael MUSTILL (United Kingdom) endorsed the comments of the previous speaker.

55. Mrs. VILUS (Yugoslavia) said that her delegation had been unhappy with the original wording of paragraph (2) (c) and was even less happy with the new version because it gave the parties unlimited autonomy, something which was far from desirable.

56. Mr. HOLTZMANN (United States of America), referring to the observation made by the Chartered Institute of Arbitrators, said that the question of *lex specialis* was discussed in a secretariat note (A/CN.9/WG.II/WP.50) prepared for the guidance of the Working Group on International Contract Practices. The note stated (p. 2, para. 3): "It seems to be clear and accepted that the Model Law is

designed to establish a special legal régime for international commercial arbitration which, in the States adopting it, would prevail over any other municipal law on arbitration." That was the concept which the *ad hoc* working party had tried to make explicit. Perhaps the objection to paragraph (4) could be overcome by the addition of the words "except as otherwise provided herein" at the end of the provision.

57. Mr. VOLKEN (Switzerland) said that he was not satisfied with paragraph (2) (c). Although he was not against the idea of opting-in, he would give preference to a solution which introduced that idea in a direct and not only in an indirect manner. In short, he would prefer the addition of a phrase to paragraph (1) to the effect that the Model Law also applied to an international commercial arbitration if the parties expressly so agreed.

58. He pointed out that, with the exception of the second sentence in paragraph (1), the first three paragraphs of article 1 concerned the field of the substantial application of the Model Law, whereas the proposed paragraphs (4) and (5) concerned the relationship of the Model Law to national laws. It therefore seemed logical that the proviso, which dealt with the relationship between the Model Law and international agreements, should be removed from paragraph (1) and become a separate paragraph, (3) *bis*.

59. The CHAIRMAN said that a majority seemed to accept the proposal in A/CN.9/XVIII/CRP.5 for paragraphs (2) (c) and (5), subject to the possibility of drafting improvements. What had not been accepted was paragraph (4). Since it had given rise to so much comment, he suggested that a note should be included in the report to the effect that the purpose of the Model Law was to cover the field of application otherwise covered by national law, but that it had been left to the legislators in States accepting the Model Law to deal with the situation as they understood it. He would take it that the Commission approved that suggestion along with the proposal for paragraphs (2) (c) and (5).

60. *It was so agreed.*

Article 2. Definitions and rules of interpretation (continued)

Article 2 (e) (continued)

61. Mr. RUZICKA (Czechoslovakia) introduced document A/CN.9/XVIII/CRP.3. He explained that the provisions on receipt of communications had been drafted as a new article because they seemed out of place in article 2.

62. The CHAIRMAN said that, unless he heard any objection, he would take it that the Commission approved the proposal in A/CN.9/XVIII/CRP.3.

63. *It was so agreed.*

Article 11. Appointment of arbitrators (continued)

Article 11 (4) (c) (continued)

64. Mr. STROHBACH (German Democratic Republic), introducing document A/CN.9/XVIII/CRP.4, said that it contained a proposal intended to avoid the need for the Model Law to give a definition of an "appointing authority". The proposal should be corrected by the insertion of the words "functions in connection with" before the words "the appointment of arbitrators". This would cover the situation

in which the parties named someone to appoint an appointing authority.

65. Mr. ROEHRICH (France) proposed that the provision should open with the words "A third person or institution ...".

66. The CHAIRMAN suggested that the proposal in A/CN.9/XVIII/CRP.4, as corrected, should be submitted to a drafting committee together with the French suggestion.

67. *It was so agreed.*

Article 14. Failure or impossibility to act (continued)

68. Mr. SEKHON (India) introduced a revised draft of article 14 (A/CN.9/XVIII/CRP.6). The words "with reasonable speed" had been placed in square brackets, which the Commission could remove if it decided that the words were necessary.

69. The CHAIRMAN suggested that the square brackets should be deleted straightaway since the earlier discussion of the article seemed to indicate that the Commission wished that notion to be included in the draft Law.

70. *It was so agreed.*

71. Mr. LEBEDEV (Union of Soviet Socialist Republics) asked how the moment of termination of the arbitrator's mandate would be decided under the new provision; and whether the second sentence of the article meant that, in the event referred to in the first sentence, either party could apply to the court to have the arbitrator continue in office.

72. Mr. SEKHON (India) said that the date of withdrawal from office was a matter of substance and had not been referred to the *ad hoc* working party. It was certainly a point that the Commission should deal with. Regarding the second question, there was a link between articles 14 and 15. For the Commission's guidance, he read out the text which the *ad hoc* working party intended to propose for article 15.

73. Mr. HOLTZMANN (United States of America) said that, after hearing the new proposal for article 15, he thought that the whole problem might be solved by employing the original version of article 14 with the addition of a sentence to the effect that the mandate of an arbitrator would also terminate if for any other reason he withdrew from his office or the parties agreed on termination. Regarding the notion of reasonable speed, he would prefer the words "without undue delay" to be used.

74. The CHAIRMAN said that in his view the United States suggestion would not cover the question of the moment of termination of the arbitrator's mandate. Where an arbitrator did not withdraw and there was no agreement between the parties on a date of termination, and where nevertheless he was unable to perform his functions or failed to act, what would be the precise moment at which his mandate terminated? Until it was terminated he was still an arbitrator.

75. Mr. SZURSKI (Observer for Poland) said that he could not accept the United States representative's suggestion. Provision must be made for situations in which there was no moment of automatic resignation. There were two possibilities: to provide that the mandate of an arbitrator terminated if he became *de jure* or *de facto* unable to perform his functions, or for other reasons failed to act, and thereby

delayed proceedings for more than a specified period; or to provide that if an arbitrator failed to withdraw when asked by the parties, the parties would have recourse to the court, which would decide whether there were really grounds for withdrawal or not.

76. Mr. BONELL (Italy) said that the new draft seemed to change the entire scope of the article by making it deal exhaustively with the terms of the arbitrator's mandate, yet he understood that the Commission's intention was not to deal with the contractual relationship between parties and arbitrators. The affirmation of the arbitrator's right to withdraw for any reason and the right of the parties to terminate his mandate for any reason, without further qualification, was a departure in substance from the original version, which he

strongly preferred, subject only to the inclusion in it of the reference to reasonable speed.

77. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that the proposal submitted by the *ad hoc* working party contained a rational element which might be used without, however, any change to the substance of the article. He himself was in favour of keeping the article as it stood, with the inclusion of a reference to reasonable speed and of a separate paragraph to deal with other reasons for the termination of an arbitrator's mandate, either by himself or by the parties. There would then be no need for that to be dealt with in article 15.

The meeting rose at 12.45 p.m.

320th Meeting

Wednesday, 12 June 1985, at 2 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 2.05 p.m.

International commercial arbitration (continued)

(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264; A/CN.9/XVIII/CRP.6-8)

Article 14. Failure or impossibility to act (continued)

1. Sir Michael MUSTILL (United Kingdom) recalled that the Working Group had exhaustively discussed at its fifth session the formulation of article 14 (A/CN.9/233, paras. 113-115). The present text was perhaps not ideal, but it was sufficiently satisfactory and did not warrant further alteration.

2. Mr. de HOYOS GUTIERREZ (Cuba) suggested that reference should be made to the efficiency as well as the speed of arbitration, since that was an equally important factor.

3. The CHAIRMAN said that it was impossible to reopen the discussion. If he heard no objection, he would take it that the Commission agreed to retain the original text of article 14 with the addition of the reference to reasonable speed (A/CN.9/XVIII/CRP.6), the exact formulation of which would be left to the drafting committee.

4. *It was so agreed.*

Article 7. Definition and form of arbitration agreement (continued)

Article 7 (2)

5. Mr. PENKOV (Observer for Bulgaria), introducing the proposed amendment (A/CN.9/XVIII/CRP.7) to the second sentence of article 7 (2), said that in all logic, an exchange of statements in which neither party denied the existence of an agreement had to be regarded as constituting an agreement in writing. Moreover, in some countries that was one of the rules of arbitration, so that difficulties would arise if the Model Law did not refer to the point. He had the impression that the majority favoured that approach.

6. Mr. GRIFFITH (Australia) suggested that the concluding phrase should be recorded to read "or in an exchange of statements of claim and defence one party alleges and the other party does not deny the existence of an agreement".

7. Mr. SZURSKI (Observer for Poland) said that the intention of the proponents of the amendment would be made clearer if the concluding phrase read "or if" in an exchange of statements of claim and defence neither party has denied the existence of an agreement".

8. Mr. SEKHON (India) supported the Australian suggestion.

9. Mr. HOLTZMANN (United States of America) said that he could accept either the Polish or the Australian formulation.

10. The CHAIRMAN suggested that the proposal in A/CN.9/XVIII/CRP.7 should be sent to the drafting committee for amendment along the lines suggested by the Australian representative.

11. *It was so agreed.*

Article 16. Competence to rule on its own jurisdiction (continued)

Article 16 (3)

12. The CHAIRMAN, introducing the proposed amendment to article 16 (3) (A/CN.9/XVIII/CRP.8), said it constituted a reasonable compromise between two divergent approaches. He drew attention to the two alternative time-limits indicated in square brackets.

13. Mr. SZURSKI (Observer for Poland) said that he had doubts about certain expressions in the proposed amendment. First, the reference in the second sentence to "a preliminary ruling" was inappropriate; the reference should be rather to a ruling on a preliminary question, which ruling should be final. Secondly, mention was made of a "notice of that ruling" but it was not clear what kind of notice was intended: was it to be an order of the court? Thirdly, it would be preferable to replace the phrase "to decide the matter" by "to decide on the jurisdiction". However, in his view, any decision or intervention by the court in the proceedings of the arbitral tribunal should be provided for only at the stage of setting aside the award. He would suggest a text on the following lines: "At the request of a party, the ruling, as a preliminary question,

should be made in the form of a preliminary award, from which each party may resort to the court specified in article 6 within 30 days after its receipt. While the question of jurisdiction is pending with the court, the arbitral tribunal may, and at the request of a party shall, continue the arbitral proceedings."

14. The CHAIRMAN said it was impossible to reopen the original debate on the article. He asked the Commission to concentrate on the question of the desirable time-limit to be imposed.

15. Mr. REINSKOU (Observer for Norway) said his delegation would prefer 30 days. He had difficulty in accepting that the court specified in article 6 should be empowered to give a final decision on such an important matter as the jurisdiction of the arbitral tribunal. There should either be provision for appeal to a higher court under article 16 or it should be possible to reopen the matter under the setting aside procedure.

16. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) enquired what would happen if a party did not take advantage of its right of recourse to the court under article 16 (3). Could that fact be regarded as a waiver if that party subsequently wished to act under article 34 to set aside the entire award, including jurisdiction?

17. The CHAIRMAN said that it would be a question of national procedural law on the authority of judicial decisions (*res judicata*).

18. Mr. GRIFFITH (Australia) said 15 days was too short a period for his country in the context of international arbitration. It was his delegation's understanding that article 21 (4) of the UNCITRAL Arbitration Rules was subsumed in article 16 (3). If such was the case, he did not wish to suggest any change in the text and would leave the matter to the discretion of the arbitrators in each particular case.

19. Mr. MOELLER (Observer for Finland) said that a period of 15 days was somewhat short, although the period need not necessarily be as long as 30 days. With regard to the concluding phrase, it was his understanding that the continuation of the arbitral proceedings could include the making of the award. He did not wish any change in the text; a record in the report would suffice.

20. Mr. de HOYOS GUTIERREZ (Cuba) pointed out that, owing to an error in the Spanish text, the decision had been described as subject to appeal.

21. The CHAIRMAN said that the point had been noted by the secretariat.

22. Sir Michael MUSTILL (United Kingdom) said that in the United Kingdom, for many years the challenge time had been six weeks. In the interests of speeding up arbitration proceedings, it had been shortened to three weeks, but that had generally been regarded as a mistake in the context of international arbitration. He also noted that the text made no provision for the court to extend the period in cases of hardship. He did not think that 15 days was a practical possibility.

23. Mr. SAMI (Iraq) said that 15 days was very short; he favoured 30 days. The phrase "such a request is pending" was ambiguous, and he suggested that it should be replaced by "which request has not been decided by the court".

24. Mr. ROEHRICH (France) said he had considerable difficulty with the compromise of introducing a new recourse to the courts in article 16 (3), which meant that article 34 would no longer provide the only means of recourse, as the secretariat's commentary on that article suggested (A/CN.9/264, p. 71, para. 1). However, since such was the case, he thought that the additional recourse should be as limited as possible. There should certainly be no question of appeal from the decision of the court, and the period should not be longer than 15 days. There were specific provisions in national legislation for extending that period in cases where the distance separating the parties concerned was considerable.

25. Mr. GRIFFITH (Australia) said that the same arguments were valid for extending the period in article 13 from 15 to 30 days.

26. Mr. SZURSKI (Observer for Poland) said that 15 days was not a practical period not only for reasons of distance but also because of the need for consultations.

27. Mr. HOLTZMANN (United States of America) noted that so far only one speaker had favoured a period of 15 days. He himself supported a 30-day period.

28. The CHAIRMAN said that, if there were no further comments, he would take it that the Commission agreed to specify a period of 30 days in article 16 (3) and, for reasons of consistency, also in article 13; it was understood that 30 days meant 30 calendar days.

29. *It was so decided.*

Article 35. Recognition and enforcement and

Article 36. Grounds for refusing recognition or enforcement

30. Sir Michael MUSTILL (United Kingdom) proposed that before engaging in a detailed discussion of article 35, the Commission should first consider the general question of whether articles 35 and 36 should be retained at all.

31. *It was so agreed.*

32. Mrs. RATIB (Egypt) said that article 35 (1) made it incumbent upon a State which had adopted the Model Law to recognize and enforce an arbitral award except in the situations described in article 35 (2) and (3). Article 36 set out a comprehensive list of grounds for refusing recognition or enforcement. Those issues were, however, covered by the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards, the success of which was universally recognized. States which had already ratified or acceded to that Convention would have no need for articles 35 and 36 of the Model Law, which would simply create useless duplication within their domestic legislation. The articles were likely to be useful only to a minority of States, which would probably accede to the 1958 New York Convention sooner or later anyway. There was therefore no reason to keep articles 35 and 36, and she proposed their deletion.

33. It might be argued that the articles should be retained because some provisions of the 1958 New York Convention were defective or ambiguous, but the solution should then be sought not by creating a potentially confusing duplication, but by reviewing that Convention and making a serious attempt to improve it.

34. Should that proposal to delete the two articles be rejected, the problems of setting aside and enforcement would

coexist within the Model Law, a phenomenon which to her knowledge was unprecedented in international texts.

35. Mr. MOELLER (Observer for Finland) said that in its written observations, Finland had urged that "no provisions on recognition and enforcement of foreign awards should be included in the Model Law, unless they are more favourable" than those contained in the 1958 New York Convention (A/CN.9/263, p. 50, para. 5). Since that was unlikely, articles 35 and 36 should be deleted.

36. Mr. SCHUETZ (Austria) supported the proposal to delete articles 35 and 36. There was an internationally recognized and satisfactory convention on the subject already, and the incorporation of similar provisions in the Model Law would cause difficulties in respect of awards made outside a State adopting it. It was, moreover, unnecessary to provide for recognition and enforcement of awards made inside the territory of a State, because under the law of many countries, including his own, an award had the same legal effect as a court ruling. For that reason as well, his delegation favoured the deletion of articles 35 and 36.

37. Mr. GRAHAM (Observer for Canada) said that his country had not been able to adopt the 1958 New York Convention because under the Canadian constitution, arbitration fell within the legislative competence of the separate Provinces and not that of the Federal Government of Canada. It therefore favoured retaining articles 35 and 36.

38. Sir Michael MUSTILL (United Kingdom) said he agreed that, in respect of awards made in foreign countries, articles 35 and 36 could be deleted but felt that the situation regarding domestic awards might be different. In the United Kingdom, for example, such awards were not self-enforcing.

39. Mr. de HOYOS GUTIERREZ (Cuba) said that his country, which had ratified the 1958 New York Convention and the 1961 Geneva Convention, believed that articles 35 and 36 added nothing to the Model Law but could cause problems; he accordingly favoured their deletion.

40. Mr. SEKHON (India) said that his delegation would also like to see the articles deleted for the reasons stated by the United Kingdom representative.

41. Mr. SAMI (Iraq) said that the articles were neither important nor useful to States which had acceded to the 1958 New York Convention. For various reasons, however, nearly half of the States Members of the United Nations, including his own, had not done so. The Commission should therefore give serious consideration to enabling States which had not ratified the Convention to ensure the enforcement in their territory of awards handed down in other countries and thereby achieve uniformity in international commercial arbitration. There was no harm in keeping the articles in the Model Law, and he supported the Canadian proposal to retain articles 35 and 36.

42. Mr. LOEFMARCK (Sweden) said that his delegation had initially advocated the deletion of the articles but it now felt that there would be a substantial gap in the Model Law if no reference was made therein to the enforcement of awards. The articles would be useful to those States which had not acceded to the 1958 New York Convention.

43. Mr. HOELLERING (United States of America) said that he favoured the retention of articles 35 and 36. Many countries might find it much easier to use the Model Law than to accede to the 1958 New York Convention. Article 35 would be needed even if foreign awards were not covered in the Model Law; his delegation would, however, prefer provisions on both domestic and foreign awards to be incorporated. Lastly, in the footnote to article 35, the word "onerous" seemed somewhat too strong.

44. Mr. ROEHRICH (France) said that although his country had ratified the 1958 New York Convention, he would prefer articles 35 and 36 to be retained. If they were deleted, the Model Law would contain no reference to ways of facilitating the recognition and enforcement of arbitral awards. He proposed, however, that when the Model Law was transmitted to the General Assembly, it should be accompanied by an UNCITRAL request to the Sixth Committee to invite States that had not yet done so to consider ratifying the 1958 New York Convention or to be guided by that Convention in their domestic legislation and in the conclusion of bilateral agreements. Consistent provisions on international commercial arbitration would be an indispensable supplement to national legislation.

45. Mr. JOKO-SMART (Sierra Leone) said that the only reason advanced for the deletion of articles 35 and 36 had been that they duplicated provisions in the 1958 New York Convention. Many countries, however, had not ratified that Convention, including his own. Sierra Leone was extremely interested in the Model Law and believed that in order to make it as comprehensive as possible, articles 35 and 36 should be retained.

46. Mr. TAN (Singapore) said that his country was not a party to the 1958 New York Convention; since articles 35 and 36 would be of assistance to States like his, they should be retained.

47. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that the Model Law was intended to promote both consolidation and comprehensiveness of national legislation. Some countries might have legislation that was superior to the provisions of the Model Law, but others did not. The only substantial argument advanced against articles 35 and 36 had been that they were superfluous, but that was not the case for all countries. The Commission was expected to produce a finished product, and without provisions on recognition and enforcement, the Model Law would be incomplete. Even if the articles did not embody a better régime than that provided for in the 1958 New York Convention, some provisions on recognition and enforcement would still be useful in the Model Law. Moreover, since article 1 (1) provided that the Model Law did not affect multilateral or bilateral agreements, there would be no problem of conflict with such agreements.

48. Even though it had been highly praised, the 1958 New York Convention had been adopted by only 60 or 70 countries. At least some of those which had not so far adopted the Convention could, by using the Model Law, make essential changes in their domestic legislation. He supported the proposal by the representative of France that when the Model Law was transmitted to the Sixth Committee, the Commission should at the same time refer to the numerous General Assembly resolutions which had invited countries that had not yet ratified the 1958 New York Convention to do so as soon as possible.

49. Mr. RUZICKA (Czechoslovakia) urged the retention of the articles, which would not prevent countries from ratifying the 1958 New York Convention.

50. Mr. BONELL (Italy) said that he favoured the retention of the articles for the reasons advanced by the representative of the Soviet Union.

51. Mr. TORNARITIS (Cyprus) said that although the Egyptian argument about duplication was convincing, his delegation supported the retention of the articles.

52. Mr. TANG Houzhi (China) said that his Government was considering accession to the 1958 New York Convention. He had no strong feelings about the deletion of the articles but hoped that, if the Commission decided to retain them, their content would not go beyond what was set out in that Convention.

53. Mr. LAVINA (Philippines) said that his delegation associated itself with the views expressed by the delegations of the United States, Sierra Leone and the Soviet Union. The place of arbitration and the place of award were not always the same, and there might be a hiatus in enforcement if provisions like those in articles 35 and 36 were not included in the Model Law. Moreover, there was no conflict between the Model Law and the 1958 New York Convention; the Model Law would actually supplement that Convention.

54. Mr. VOLKEN (Observer for Switzerland) said that the main argument put forward in favour of the deletion of the articles had been that there was already a Convention on the subject, but only about 64 countries had actually ratified or acceded to it. Article I (3) of the 1958 New York Convention stated that, when signing, ratifying or acceding to it, any State could declare that it would apply it to the recognition and enforcement of awards made only in the territory of another contracting State. Thirty-eight countries had chosen to take advantage of that provision. That left only 26 States which applied the Convention *erga omnes* and which would not be served by the inclusion of similar provisions in the Model Law. For that reason, articles 35 and 36 should be retained.

55. Mr. SONO (Secretary of the Commission) noted that 66 States had now ratified or acceded to the Convention, Guatemala and Panama being the most recent.

56. The CHAIRMAN noted that the majority seemed to favour the retention of the articles. If he heard no objection, he would therefore take it that the Commission could commence a detailed discussion of the provisions of the articles.

57. *It was so agreed.*

58. The CHAIRMAN invited comments on article 35 (1).

59. Mr. BONELL (Italy) thought that it might be advisable to specify the type of award envisaged in articles 35 and 36. It should be made clear that they referred only to awards rendered in respect of international commercial arbitration as defined in article 1.

60. Mr. HERRMANN (International Trade Law Branch) said that the secretariat had been requested to prepare a draft provision on the territorial scope of application of the Model Law for consideration by the Commission and to indicate the possible exceptions to it. He felt that the best procedure would be to await the outcome of the Commission's debate in order to ascertain whether there was a need to retain the phrase "irrespective of the country in which it was made" in articles 35 and 36. It might be possible to express that thought in the context of the territorial scope of application. The Italian representative's suggestion, however, also involved the substantive point of whether articles 35 and 36 should be wider in scope than international commercial arbitration only: that would, in a sense, be in line with the 1958 New York Convention. Purely from the point of view of drafting, it would be better to postpone the decision on whether to retain an explicit reference to the idea that the recognition and enforcement provisions covered an arbitral award irrespective of the country in which it was made, and to take that decision after deciding on the question of the territorial scope of application.

61. Mr. ZUBOV (Union of Soviet Socialist Republics) said that his delegation's views on article 35 were outlined in its written comments (A/CN.9/263, p. 52, para. 2). There were, however, a number of other considerations to be envisaged in regard to the article. For example, the draft contained no explicit provision as to the time at which an award became recognized as binding, although subparagraph (a) (v) of article 36 (1) said that enforcement of an arbitral award could be refused if the award had not yet become binding on the parties. The question of when the award became binding must be decided in accordance with the law applied by the State in which the award had been made. In the case of an award made "in this State", there should probably be an indication that it became binding in accordance with the law of "this State". In article 31, on the form and content of the award, a provision could appropriately be inserted to require an indication of the time at which an award became binding.

62. The CHAIRMAN said that the general question as to when an award became binding related more to the earlier articles. The question whether a decision to recognize an award should have a retroactive effect or not was a question that ought perhaps to be dealt with in article 35.

63. Mr. ROEHRICH (France) said that the retroactivity of the effect of the recognition of an award was a very controversial point that was best left open. The general question of when an award became recognized as binding on the parties should perhaps be dealt with.

64. The CHAIRMAN thought it would be advisable to leave that point to the discussion on the articles relating to awards which came before article 31. He believed that the point raised by the Italian delegation had been settled by the explanation from the secretariat.

65. Mr. BONELL (Italy) still thought that difficulties would arise unless it was specified that article 35 referred to arbitral awards rendered in respect of disputes that fell within the scope of article 1 of the Model Law. As far as awards rendered within the territory of the same State were concerned, that could go without saying, but problems could arise in respect of awards rendered abroad. For example, an award rendered in Italy that was not of a character dealt with by the

Model Law would not fall under articles 35 and 36, whereas an award of the same kind rendered abroad would fall under them.

66. Mr. HOLTZMANN (United States of America) asked what would happen in the case of a domestic arbitration in a State (other than the State in which enforcement was sought) which did not meet the standards of international commercial arbitration according to any of the established tests, a case where, after the award had been rendered in that State the losing party took all its property to another State; the winning party then sought to enforce that purely domestic award in the latter State because that was where the losing party's assets were lodged. Was article 35 intended to provide for recognition in such a case or not? It would be provided for in the 1958 New York Convention and, as he saw it, the provision in the Model Law would also cover it.

67. The CHAIRMAN believed that it would not, if the case was not one of international commercial arbitration within the Commission's definition. Article 35 could not exceed the field of application of the other provisions of the Model Law. The Commission's task was to consider matters of international trade law. Arbitration that was purely domestic, or not commercial, would not be covered by the Model Law.

68. Mr. HOLTZMANN (United States of America) said that, in that case, it would be wise, for purposes of clarity, to meet the point made by Italy.

69. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) felt that the provision was quite unambiguous. The award in question must be an award to which the Model Law was directed. If the award whose application was sought was domestic, it was covered by the 1958 New York Convention.

70. Mr. JARVIN (Observer for the International Chamber of Commerce) suggested that, in order to clarify the position, the grounds for refusing recognition might be expanded to include the fact that the award was not an international award within the meaning of the Model Law.

71. Mr. CHO (Observer for the Republic of Korea) said that it might be better to make a distinction in the character of arbitral awards even if the Commission accepted the territorial scope of application, and to state the exceptions clearly. Awards made within the territory of "this State" under the Model Law and other provisions of domestic law could be enforced under the provisions of the Model Law. On the other hand, awards made outside the territory of "this State" and under foreign law were dealt with by the 1958 New York Convention. There were other situations, as his delegation had pointed out in its comments (A/CN.9/263, p. 49, para. 2), for example an award made outside the territory of "this State" under "this Law" or made in the territory of "this State" under a foreign law. There should be guidelines for the recognition and enforcement of such awards.

321st Meeting

Thursday, 13 June 1985, at 9.30 a.m.

Chairman: Mr. PAES de BARROS LEAES (Brazil)

The meeting was called to order at 9.45 a.m.

International commercial arbitration (*continued*)
(A/CN.9/246, annex; A/CN.9/263, and Add.1-2; A/CN.9/264)

Article 20. Place of arbitration

Paragraph (1)

1. Mr. SEKHON (India) proposed that the following words should be added at the end of the paragraph: "having regard to the circumstances of the arbitration, including the convenience of the parties".

2. Mr. BROCHES (Observer, International Council for Commercial Arbitration) said that such a change would be consistent with the view taken earlier of the notion of the place of arbitration, at a stage in the history of the Model Law when factors of that kind had been considered relevant for inclusion. It was somewhat out of harmony, however, with current opinion on the matter, in which the selection of the place of arbitration was associated with the determination of the applicable law.

3. Mr. GRAHAM (Observer for Canada) supported the proposal and said it was a reasonable one.

4. Lord WILBERFORCE (Observer, Chartered Institute of Arbitrators) said that the idea was useful as a guide but it should be expressed in a comment separate from the article itself.

5. Mr. HOLTZMANN (United States of America) supported the suggestion made by the preceding speaker. However, the comment should be confined to mentioning the circumstances of the arbitration. That would be in line with article 16 (1) of the UNCITRAL Arbitration Rules. If the convenience of the parties was mentioned it would appear to give it more prominence than other relevant factors, say, enforceability of the award or whether a State had adopted the Model Law. With a comment of the kind he had mentioned, the actual text of the Model Law would leave the arbitrators' discretion clear and unqualified, and that was probably desirable for a piece of legislation.

6. Mr. ROEHRICH (France) strongly supported the Indian proposal. The wording should be added to the article itself. A rule of that kind would provide sound guidance for the arbitral tribunal.

7. Mr. BOUBAZINE (Algeria) and Mr. LAVINA (Philippines) said they approved the Indian amendment and its inclusion in the article itself.

8. Mr. TANG Houzhi (China) likewise supported the Indian amendment and favoured its inclusion in the article, since the convenience of the parties was an important factor. While it was right to take the UNCITRAL Arbitration Rules into account, there was no need to copy them word for word.

9. Mr. JOKO-SMART (Sierra Leone) said that he was unable to support the Indian proposal, excellent though the idea was. In the first place, there were the reasons mentioned by the United States; also, the parties might not be able to specify a place convenient to both of them.

10. Mr. de HOYOS GUTIERREZ (Cuba) said he favoured the inclusion of the wording of the Indian proposal in the text of the article. It was important to give the arbitral tribunal guidance on the need to take account of the parties' convenience.

11. Mr. CHO (Observer for the Republic of Korea) supported the Indian proposal except for the inclusion of the reference to the convenience of the parties. It would be best to keep to what was in article 16 (1) of the UNCITRAL Arbitration Rules, since there could be a conflict between the parties about what place was convenient for them. Moreover, the meaning of convenience was implicit in the words "the circumstances of the arbitration".

12. Mr. LOEFMARCK (Sweden) opposed the idea of amending the text of the article itself, for the reasons given by the Observer for the Chartered Institute of Arbitrators and the representatives of the United States of America and Sierra Leone. He could accept a separate comment mentioning the UNCITRAL Rules and the circumstances of the arbitration, but not the parties' convenience.

13. Mr. OLUKOLU (Nigeria) supported the Indian proposal for the reason given by the representative of France. It was important to take the convenience of the parties into account.

14. Mr. ABOUL ENFIN (Observer for the Cairo Regional Centre for Commercial Arbitration) said that he approved the Indian proposal and the inclusion of the wording in the article itself.

15. Mr. TORNARITIS (Cyprus) observed that the circumstances in question were normally taken into consideration by arbitrators anyway. He could nevertheless accept the Indian proposal and agreed that the wording should be added to the text of the article.

16. Mr. BARRERA GRAF (Mexico) said that he approved the proposal to add to paragraph (1) a reference to the circumstances of the arbitration, which would be in keeping with the UNCITRAL Arbitration Rules. He did not agree about the proposed reference to the convenience of the parties, a subject which would be more appropriate for the last paragraph of article 19. He shared the views of the Observer for the Republic of Korea and the United States representative.

17. Mr. SCHUETZ (Austria) said he approved the text as it stood but was prepared to accept the addition of a reference to the circumstances of the arbitration and a mention in a comment that they included the question of the convenience of the parties. His delegation suggested that course of action as a compromise. It particularly supported the view expressed by the representative of Sierra Leone.

18. Mr. BONELL (Italy) supported the Indian proposal.

19. Mr. HJERNER (Observer for the International Chamber of Commerce) said that it was not appropriate to include directives in a law. He supported the view expressed by the Observer for the Chartered Institute of Arbitrators. If, however, a criterion for determining the place of arbitration had to be mentioned, it should be enforceability of the award.

20. Mr. SCHUMACHER (Federal Republic of Germany) said that he approved the Indian proposal in principle, but felt that the question of the convenience of the parties should be dealt with in a separate comment referring to the principles laid down in article 19 (3).

21. Mr. MTANGO (United Republic of Tanzania) also supported the Indian proposal. Although it could be argued that it would make little difference whether the second part were included or not, he felt that it helped to clarify the article and would therefore assist users of the Model Law.

22. Mr. HOLTZMANN (United States of America) endorsed the Austrian compromise suggestion. However, in mentioning the convenience of the parties, the comment should make it clear that not only physical convenience but other relevant factors, such as the suitability of the law of the place of arbitration and the effect of the choice of place on the enforceability of the award under the New York Convention or bilateral agreements, should be taken into account by the arbitrators.

23. Mr. BONELL (Italy) agreed with the previous speaker's remarks.

24. Mr. SAMI (Iraq) said that he supported the idea of adding to the article, which should make it clear that the place of arbitration must be convenient for the parties. That was very important, especially for developing countries. At a recent meeting of the Asian-African Legal Consultative Committee, delegates had pointed out the undesirability of choosing a place which would involve heavy travel costs for the parties; they had stressed that it should be in or near to where one of the parties resided, and in the developing country in the case of an arbitration between a party in a developing country and one in a developed country. There were also the considerations mentioned by Norway in its written comments, reproduced in document A/CN.9/263 (p. 33, para. 2). The arbitrators should give due heed to all the criteria mentioned by the United States representative, especially the enforceability of the award.

25. The CHAIRMAN said that there seemed to be considerable support for the Indian proposal. Unless he heard any objections, he would take it that the Commission wished to approve the paragraph as amended by that proposal.

26. *It was so agreed.*

Paragraph (2)

27. Mr. LAVINA (Philippines) said that account should be taken of the laws of the place at which it was envisaged hearing witnesses, experts or parties.

28. *The Commission approved paragraph (2).*

Article 21. Commencement of arbitral proceedings

29. Mr. RUZICKA (Czechoslovakia) drew attention to his country's written proposal concerning limitation of claims, reproduced in document A/CN.9/263, (p. 34 (article 21), para. 2). His delegation considered that the date of the start of the arbitration had extremely important consequences for the extinction of a party's claim and that it would be useful if the Model Law made them clear.

30. Mr. ROGERS (Australia) said that the proposal would involve changes in national statutory limitations which went beyond the functions of the Model Law. While appreciating the thought that had gone into the proposal, he felt it would be disadvantageous to adopt it.

31. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that his delegation welcomed the idea underlying the Czechoslovak proposal, which took account of practical situations and sought to establish a unified rule on prescription. If arbitral proceedings began shortly before the expiry of the claimant's time-limit for bringing his claim and the respondent raised the question of jurisdiction, it might be only after a long delay that the arbitrators were found not to have jurisdiction; the claimant would then be debarred from taking his claim to a court because the time-limit for doing so would have expired. The problem was dealt with *expressis verbis* in very few existing national legislations and it often proved difficult to settle. He thought that most delegations would agree that it would be useful to incorporate a clear rule on the subject in the Model Law. If the Commission accepted the Czechoslovak proposal in principle, it would not be difficult to draft wording suitable for that purpose.

32. Mr. SCHUETZ (Austria) said that the Working Group on International Contract Practices had decided that the Model Law should not include a provision along the lines of the Czechoslovak proposal precisely because views on the matter differed so much. He agreed with the representative of Australia that the issue was too closely connected with material law for it to be included in the Model Law.

33. Mr. MOELLER (Observer for Finland) said that he had some sympathy for the Czechoslovak proposal. Nevertheless, if the provisions suggested were included in the Model Law, the Commission would be exceeding its mandate and venturing into an area where there were big differences among legal systems.

34. Mr. ROEHRICH (France) said that he understood the concerns expressed by the representatives of Czechoslovakia and the Soviet Union but did not think it would be feasible to include the proposed wording in the Model Law. Perhaps the Commission's report could draw the attention of Governments to the possible need for regulating the matter. Legislators could then, if they wished, adopt a unified provision on the subject for their internal law and for international commercial arbitration.

35. Mr. STROHBACH (German Democratic Republic) said that his delegation supported the Czechoslovak proposal, in which the paragraph referring to limitation was particularly important. He noted that the aim of the Model Law was to promote international commercial arbitration and it was appropriate, therefore, that it should include such a provision.

36. Mr. BOGGIANO (Observer for Argentina) said that his delegation, too, supported the Czechoslovak proposal, although it was not sure whether it related to material law or

procedural law. The proposal would promote the effectiveness of the arbitration system and help to protect the substantive rights of the parties.

37. Mr. SONO (Secretary of the Commission) noted that the 1974 New York Convention on the Limitation Period in the International Sale of Goods did not take a position as to whether limitation was a question of substance or procedure. That Convention would shortly enter into force, at almost the same time as the 1980 United Nations Convention on Contracts for the International Sale of Goods, which raised arbitration to the level of normal judicial proceedings and had indirectly helped to enhance the popularity of international commercial arbitration. The 1980 Convention provided that if a claim was filed, through either judicial or arbitration proceedings, the period of limitation ceased to run. The underlying idea of the first paragraph of the Czechoslovak proposal was contained in the 1980 Vienna Convention, while the second paragraph corresponded to a provision in the 1974 New York Convention.

38. Mr. RAMADAN (Egypt) said that he understood the reasons for the Czechoslovak proposal but thought that the issue it covered was better left to the sphere of material law. His delegation supported the Japanese proposal mentioned in document A/CN.9/263 (p. 34 (article 21), para. 3).

39. Mr. GRAHAM (Observer for Canada) said that, for the reasons given by a number of previous speakers, his delegation had difficulty in accepting the Czechoslovak proposal. Furthermore, it represented a departure from article 1 as approved by the Commission; it was similar in nature to the proposal which had been made in document A/CN.9/XVIII/CRP.5 for a new paragraph (4) to article 1, a proposal which the Commission had rejected.

40. Mr. AYLING (United Kingdom) said that the Working Group had considered the matter of prescription and had decided, with his delegation's support, that it would be wrong to include it in the Model Law. The Czechoslovak proposal had merit and the problem it raised was certainly a real one, but it should not be dealt with in the Model Law.

41. Mr. SZURSKI (Observer for Poland) said that his delegation supported the Czechoslovak proposal. It would promote the Commission's purpose, which was to enhance the effectiveness of international commercial arbitration.

42. Mr. VOLKEN (Observer for Switzerland) said that he could not understand the reservations which some delegations had concerning the Czechoslovak proposal. The problem was one often encountered in practice and, since the purpose of the Model Law was to promote international commercial arbitration, the Commission should try to deal with practical problems. His delegation could accept the Czechoslovak proposal but thought that it might be better for it to appear as a separate article rather than as part of article 21.

43. Mr. de HOYOS GUTIERREZ (Cuba) said that his delegation supported the principle expressed in the Czechoslovak proposal but thought that the wording needed to be reworked in the drafting committee.

44. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) said that her delegation could not support either part

of the Czechoslovak proposal because both portions conflicted with domestic legislation on a matter lying outside the scope of the Model Law.

45. Mr. SAWADA (Japan) said that his delegation would be unable to accept the Czechoslovak proposal, which conflicted with his country's domestic law. He pointed out that the title of article 21 was "Commencement of arbitral proceedings", and he commended to the Commission his country's written proposal which dealt precisely with that point and had already been supported by the representative of Egypt.

46. Mr. BARRERA GRAF (Mexico) said that his delegation preferred the existing text of the article. The Czechoslovak proposal raised the complex problem of prescription, which could hardly be dealt with in a Model Law. The Working Group had come to that conclusion and there was no need for the debate on the subject to be repeated in the Commission.

47. Mr. ENAYATI (Observer for the Islamic Republic of Iran) said that, for the reasons given by previous speakers and in the light of the explanation given by the Secretary, he had no difficulty with the Czechoslovak proposal. He did, however, have doubts about the Japanese proposal.

48. Mr. PENKOV (Observer for Bulgaria) said that his delegation endorsed the statements made by the representative of the Soviet Union and by other speakers in support of the Czechoslovak proposal.

49. Mr. LOEFMARCK (Sweden) said that he understood the purpose of paragraph (1) of the Czechoslovak proposal but he thought that the provision should cover questions of limitation only: he could not accept that the request itself should have the same effects as if filed with a court. Subject to that qualification, his delegation could support the provision. It had no difficulty in accepting paragraph (2) of the proposal.

50. Mr. ILLESCAS ORTIZ (Spain) said that his delegation could not accept the Czechoslovak proposal. It would be very difficult to establish uniform international practice in such a complex matter as prescription.

51. Mr. HOLTZMANN (United States of America) said that the provision proposed by Czechoslovakia would be observed in the United States under existing laws. The provision was a valuable one but should not be included in the Model Law at such a late stage.

52. Mr. MATHANJIUKI (Kenya) said that the Czechoslovak proposal did not cover all possible cases.

53. The Japanese proposal made an undesirable distinction between *ad hoc* arbitration and arbitration by a recognized institution, which was not consistent with the new article 3 and the rest of article 21.

54. Mr. SEKHON (India), Mr. JOKO-SMART (Sierra Leone), Mr. ABOUL ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) and Mr. AYLING (United Kingdom) expressed a preference for the original version of the text.

55. Mr. MTANGO (United Republic of Tanzania) suggested that the widespread support expressed for the Czechoslovak proposal should be reflected in the report.

56. Mr. RUZICKA (Czechoslovakia) withdrew his delegation's proposal for article 21. He said he hoped that the Commission might find time to resume discussion of the matter at a later stage.

57. Mr. LEBEDEV (Union of Soviet Socialist Republics), supported by Mr. HOLTZMANN (United States of America), endorsed the Tanzanian suggestion and hoped that States adopting the Model Law would take the ideas underlying the Czechoslovak proposal into consideration.

58. Mr. SAWADA (Japan) said that his Government's proposal did not intend to discriminate between *ad hoc* arbitration and arbitration by arbitral institutions. It was simply that the date of commencement of arbitration needed to be fixed in the latter case as well, because it affected the prescription period.

59. Mr. MOELLER (Observer for Finland) said that the Japanese proposal was unacceptable. There were many types of arbitral institution with their own rules about the commencement of arbitral proceedings, and these rules would override the provisions of the Model Law.

60. Mr. ROEHRICH (France) said that he, too, found the Japanese proposal unacceptable, since some arbitral institutions did not in fact arbitrate themselves but were merely responsible for making the arrangements. In that case, there would be delay before the respondent was informed of the existence of arbitral proceedings.

61. Mr. de HOYOS GUTIERREZ (Cuba) said that the Japanese proposal would be acceptable in his country because it was consistent with existing laws.

62. Mr. HOELLERING (United States of America) said that the Japanese proposal would at least establish beyond doubt that a request for arbitration had been made. He nevertheless agreed with the French representative and the Observer for Finland that receipt of the request for arbitration by the arbitral institution would not mark the beginning of the arbitral process under all systems.

63. Ms. VILUS (Yugoslavia) said that the Japanese proposal would provide an objective indication of the commencement of arbitral proceedings and her delegation was therefore prepared to accept it.

64. Mr. STROHBACH (German Democratic Republic) pointed out that the Japanese proposal was not consistent with the principle of party autonomy expressed in the existing text of the article and in fact made the article a mandatory provision.

65. Mr. SAWADA (Japan) withdrew his Government's proposal.

66. The CHAIRMAN said that it seemed to be the wish of the Commission to keep article 21 as it stood and to make a reference in the report to the issue raised by the Czechoslovak proposal.

67. *It was so agreed.*

Article 22. Language

68. Mr. RAMADAN (Egypt), supported by Mr. ABOUL ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration), proposed that paragraph (2) should be amended by the addition of the words "or one of the languages" after the words "language or languages". The possibility which the paragraph would then provide could save parties time and money.

69. Mr. JARVIN (Observer for the International Chamber of Commerce) proposed that an addition should be made to the second sentence of paragraph (1) to the effect that a party should be allowed to use the language of his choice on condition that a translation into the language or languages determined by the tribunal was provided.

70. Mr. CHO (Observer for the Republic of Korea) said that paragraph (1) should be worded so as to ensure each party equality and the opportunity to present his case. He supported the written suggestion of the Federal Republic of Germany on that subject (A/CN.9/263, p. 34).

71. Mr. ABOUL ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration), speaking on paragraph (1), said that each party should have the right to ask for oral and written material to be translated into his own language.

72. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) agreed with the Observer for the International Chamber of Commerce that each party should have the right to use his own language in arbitral proceedings. That principle was acknowledged in the secretariat's commentary (A/CN.9/264, p. 50, para. 4).

73. Mr. LAVINA (Philippines) suggested that one or two of the official United Nations languages, or a language widely used in commerce, should be used as the language for arbitral proceedings.

74. Mr. HOLTZMANN (United States of America) said that the principle of the right to use one's own language was already safeguarded in article 19 (3), as the Federal Republic of Germany had pointed out in its written comments (A/CN.9/263, p. 34). However, the considerable cost of providing translations should also be taken into account. A party might request translations of all documents in an attempt to delay arbitral proceedings or harass its opponent. The arbitral tribunal should be given discretion in the matter of translation, as provided in the present text of article 22.

75. The proposal made by the Observer for the International Chamber of Commerce would be difficult to express in the article in its present form. A more flexible course was suggested by the secretariat's commentary (A/CN.9/264, p. 50, para. 4), namely that the party should arrange, or at least pay, for the translation into the language of the proceedings.

76. Mr. SAMI (Iraq) said that the expense of translation services was secondary to the principle that each party had the right to present his case in his own language. Parties entering into arbitration were aware that it was an expensive procedure. He said that, if an arbitral tribunal chose the language of one party as the official language of the proceedings, the costs of translation into the language of the other party should be included in the overall costs of the arbitration.

The meeting rose at 12.40 p.m.

322nd Meeting

13 June 1985, at 2 p.m.

Chairman: Mr. PAES de BARROS de LEAES (Brazil)

The meeting was called to order at 2.15 p.m.

International commercial arbitration (*continued*)
(A/CN.9/264, annex; A/CN.9/263 and Add.1-2; A/CN.9/264)

Article 22. Language (continued)

1. Mr. HERRMANN (International Trade Law Branch) said that the purpose of article 22 (1) was to allow the arbitral tribunal to determine the language or languages to be used in the proceedings. Article 22 (2) empowered the tribunal to require translations of documents. The Working Group had assumed that, since the languages chosen would constitute the languages of the proceedings, translation and interpretation would be part of the costs. The Commission might wish to clarify that there was no intention of preventing a party or a witness from expressing his views in his own language.

2. Mr. ROGERS (Australia) said that he realized that the suggestions made for changes in article 20 and now in article 22 had been motivated by a desire to ensure the overall

fairness of the proceedings. At the same time, he was disturbed by what seemed to be a tendency to limit the arbitrators' discretion and to regulate the proceedings in minute detail. What had been described as the "Magna Carta of arbitral procedure" (A/CN.9/264, p. 44) was enshrined in article 19, and more especially in article 19 (3) in the form of the essential requirement that "the parties shall be treated with equality and each party should be given a full opportunity of presenting his case". That provision should satisfy the needs of those delegations which wished to introduce amendments. In selecting their arbitrators, the parties entrusted them with extensive powers to decide matters of fact and of law. Since the arbitrators were already entrusted with such wide decision-making powers, it could be left to them to act fairly and properly, in accordance with article 19, without trying to anticipate every procedural problem that could arise. It was not possible to foresee every circumstance and to cater for every possible difficulty. His delegation was therefore opposed to any change in article 22.

3. Mr. SAMI (Iraq) said that his delegation had agreed with the Observer for the International Chamber of Commerce in regard to the principle of giving equal treatment to each side in respect of the presentation of the case. Its own proposal had been limited to a situation in which, in the case of disagreement on the language or languages to be used in the arbitral proceedings, those of the two parties should constitute the working languages of the proceedings. If the arbitration agreement opted for the language of one of the parties, however, all documents should be translated for the purposes of the other party and the cost should be an integral part of the arbitration costs and thus be borne by the losing party, except in the case of an agreement to share the costs.

4. Mr. CHO (Observer for the Republic of Korea) thought that, if the guideline in the second sentence of article 22 (1) was clarified, the third sentence would become unnecessary.

5. Mr. AYLING (United Kingdom) said that the overriding objective regarding the details of the arbitral proceedings was that the parties should be treated fairly. Language could be an important aspect of the proceedings and was therefore covered by article 19 (3). The second objective was one of practicality. Arbitral proceedings should be capable of being held in the manner which was most practical and convenient in the light of the circumstances and facts of the case. Requirements could vary enormously from case to case. Both those objectives were satisfied by the existing text of article 22 and he therefore strongly supported the position of Australia.

6. Mr. BOUBAZINE (Algeria) said that his delegation supported the proposal by Iraq as being intended to ensure equal respect for languages and the sharing of the costs of arbitration.

7. Mr. MTANGO (United Republic of Tanzania) suggested that paragraph (3) of article 19 should become a separate article. That would have the advantage of raising the status of equality of treatment and making it clear that the principle applied to the whole of chapter V. That would also solve the problem in regard to languages and there would be no need to amend article 22 (2).

8. Mr. SEKHON (India) supported the view expressed by the delegation of Iraq. He was not sure that, as it stood, the wording of article 22 would enable a party to use the best possible vehicle for putting forward his case, namely his own language. It was argued that, on the basis of the provision in article 19 (3), the dictates of fairness would require each party to have an opportunity to present his case in his own language. He felt, however, that the special provisions of article 22 excluded the general provisions of article 19. Regarding article 22 (2) his delegation felt that the word "translation" should be preceded by the phrase "duly certified". That would bring it into conformity with the provisions of article 35 (2) and would help to clarify the term "translation", which was not defined anywhere in the Model Law.

9. Mr. SCHUMACHER (Federal Republic of Germany) continued to believe that his delegation's proposal to amend article 22 by inserting a reference to article 19 (3) would constitute a useful compromise. Language constituted a greater problem for some States, including his own, whose languages were not those in wide use.

10. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that judges and arbitrators had had to deal with the problem of different languages since arbitration first began. He urged the members of the

Commission to trust the arbitrators in the matter. The arbitrators themselves might have three different languages, none of which was the language of the parties. Their first task would obviously be to consider how best to carry on their work in the circumstances. If the arbitrators were not trusted, the procedure itself was not trusted and would become an exercise in futility. It was impossible to legislate for all situations, nor could there be any universal solution, since a party's use of his own language might not be satisfactory if all the documents were in some other language. Article 22 was already too prescriptive. The guiding principle was that stated in article 19 (3), and it should be left to the arbitrators to apply it.

11. Mr. RAMADAN (Egypt) supported the proposal of Iraq, which he found similar to the proposal of the Observer for the Cairo Regional Centre for Commercial Arbitration.

12. Mr. GRAHAM (Observer for Canada) said that his delegation was satisfied with the article as it stood, although the amendment suggested by the Federal Republic of Germany would help to ensure that the elements of equality and fairness were maintained.

13. The CHAIRMAN noted that there did not seem to be sufficient support for the proposal of Iraq.

14. Mr. SCHUMACHER (Federal Republic of Germany) said that his delegation would not insist on its proposal since it too lacked any strong support.

15. Mr. SEKHON (India) asked the Chairman for a ruling on his delegation's proposal to insert the words "duly certified" in article 22 (2).

16. Mr. HOLTZMANN (United States of America) said that his delegation had agreed to the use of the expression "duly certified" in article 35 (2) because the documents therein mentioned were being submitted to a court which would have its own definition of "duly certified". In article 22, the Commission would be asking the arbitrators to say what constituted a certified translation. Actually, good translations could often be provided by the parties themselves. Where outside certified translators had to be used, the cost invariably rose. His delegation joined the Observer for the Chartered Institute of Arbitrators in urging the Commission to trust the arbitrators and not to get involved in the technical details of the proceedings.

17. Mr. HUNTER (Observer for the International Bar Association) agreed with the United States representative. He was aware, as a practitioner, that outside translation arrangements could be very disruptive and time-consuming.

18. Mr. RAMADAN (Egypt) recalled that his delegation had also made a proposal to amend article 22 (2) by inserting the phrase "one of the" before "languages".

19. Mr. LOEFMARCK (Sweden) had no objection in principle but thought that the concept behind the Egyptian proposal was already implicit in the existing wording.

20. Mr. HOLTZMANN (United States of America) felt that the arbitrators should be left discretion to require translation into more than one language.

21. Mr. HERRMANN (International Trade Law Branch) said it was his understanding that the Egyptian representative had feared that the phrase "the language or languages" might be misinterpreted as requiring translation of documents into

two languages without allowing the discretion of requiring translation into only one language in particular cases.

22. Mr. RAMADAN (Egypt) said that in cases where the parties had agreed on the use of several languages, he would like the arbitral tribunal to be authorized to choose one of those languages, in order to save time and costs.

23. Mr. MTANGO (United Republic of Tanzania) suggested that the Egyptian representative's point could be covered by replacing the phrase "the language or languages" by "a language or languages".

24. Mr. JOKO-SMART (Sierra Leone) said he had no difficulty with the text as it stood.

25. Mr. HOLTZMANN (United States of America) suggested that the Commission should accept the Egyptian proposal in principle and leave it to the drafting committee to decide where to insert appropriate wording.

26. The CHAIRMAN said that, as he heard no objection, he would take it that article 22 was referred to the drafting committee on that basis.

27. *It was so agreed.*

28. Mr. HERRMANN (International Trade Law Branch) referred to the earlier proposal made by the representative of the United Republic of Tanzania. It had always been the understanding of the Working Group, as was indicated in the secretariat's commentary on article 19 (A/CN.9/264, p. 44), that the fundamental principle enunciated in article 19 (3) would apply to arbitral proceedings in general; it would thus govern all the provisions in chapter V and other aspects, such as the composition of the arbitral tribunal, not directly regulated therein. He thought it would be within the mandate of the drafting committee, subject to the wishes of the Commission, to consider whether the fundamental principles in article 19 (3) should be highlighted by placing them in a separate article, perhaps at the beginning of chapter V.

29. Mr. AYLING (United Kingdom) recalled that the Commission had not completed its discussion of article 19. He presumed that the proposal of the representative of the United Republic of Tanzania, which his delegation supported, would be taken up when the Commission returned to that article.

30. The CHAIRMAN said that the Commission would consider the proposal at that point.

Article 23. Statements of claim and defence

Paragraph (1)

31. Mr. AYLING (United Kingdom) referred to the discussion in the Working Group on the subject of whether certain provisions of the Model Law should be mandatory or not (A/CN.9/246, p. 43). His delegation, like the United States in its written comments on article 23 (1) (A/CN.9/263, p. 35, para. 2), considered that the form of statements of claim and defence should be subject to the agreement of the parties. There were cases, such as those relating to the quality of commodities or to claims which had been set out in correspondence between the parties, where written pleadings were inappropriate.

32. Lord WILBERFORCE (Observer for the Chartered Institute of Arbitrators) said that the article related to the

mechanics of arbitration and his organization felt that such matters should be left to the arbitrators and not legislated in great detail. The first part of article 23 was cast in mandatory form, but the question of statements of claim and defence should be left instead to the parties concerned, who could adopt suitable institutional rules to fit the case. The amendment proposed by the United Kingdom delegation would meet his concern.

33. Mr. HUNTER (Observer for the International Bar Association) agreed with the two previous speakers. Arrangements should be flexible and where the parties so agreed, there was no necessity for formal statements of claim and defence.

34. Mr. ROEHRICH (France) said that he understood the practical reasons which had motivated the United Kingdom proposal but he was concerned at the possible consequences of adopting it. Article 23 embodied the basic principle of providing the claimant and the respondent with the opportunity to state their respective cases. There could be flexibility as to the manner of their presentation, but the principle of the right of defence required that the arbitrators should be seized of all the facts involved in the dispute submitted to them. How would that be possible if, under the United Kingdom proposal, parties could agree to present neither a claim nor a response?

35. Mr. HOLTZMANN (United States of America) said he appreciated the support which had been voiced for his Government's written comments on article 23 (1) (A/CN.9/263, p. 35, para. 2), inspired by the UNCITRAL Arbitration Rules. However, a number of arbitration institutions had different rules with regard to the timing and content of pleadings. That was probably the case with the Soviet Foreign Trade Arbitration Commission and it was certainly the case with the American Arbitration Association. The latter body, which dealt annually with 40,000 cases, both national and international, only required that the initial statement should give notice of the intention to submit the dispute to arbitration and of its nature. Information as to the facts supporting the claim and the points at issue, which usually included legal and factual arguments, were not required at that stage. The Model Law, which accepted the concept of party autonomy, should permit parties to agree on the rules of an established arbitration institute or on the UNCITRAL Arbitration Rules. He therefore supported the United Kingdom amendment.

36. Mr. SAMI (Iraq) said that article 23 (1) should not be deleted. He agreed with the French representative that it should provide for minimum procedural standards. However, he was not opposed to the insertion of a phrase such as "unless otherwise agreed" since, as the United States representative had pointed out, there were a large number of arbitration institutes which had their own rules for pleadings.

37. Mr. BOUBAZINE (Algeria) supported the views expressed by the French representative.

38. Mr. HERRMANN (International Trade Law Branch) said that the intention of the Working Group, which had held similar discussions, had been to express a principle and it was difficult to envisage how a decision on a dispute could be reached without statements from the parties concerned. There was the question not only of timing but of whether or not the pleading should be in written form. The form of words proposed by the United Kingdom delegation appeared somewhat awkward, and he suggested the insertion in the opening phrase of the words "and in the manner" after the words

"period of time". He preferred the word "manner" to "form" since it was wider and could include aspects such as relief.

39. Mr. BARRERA GRAF (Mexico) said that the provisions in article 23 (1) were essential since they constituted the basis of the dispute submitted to arbitration. There could be no claim without a defence. He would go further and, as his Government had suggested in its written comments (A/CN.9/263, p. 55, para. 2), he urged that the text should also refer to the possibility of the respondent presenting a counter-claim. He was prepared to accept the addition to article 23 (1) proposed by the representative of the secretariat, if that would facilitate matters.

40. Mr. OLUKOLU (Nigeria) said he was in favour of the provisions not being mandatory in view of the need for flexibility. He was disposed to support the United Kingdom proposal but he was concerned that the actions of parties should nevertheless be subject to rules, which could be those applied by established arbitration institutes.

41. Mr. de HOYOS GUTIERREZ (Cuba) supported the present text of article 23 (1). A time-limit should be set for claims, and the statements of both parties must be accompanied by relevant proof, even if some arbitration institutes did not insist upon it. One of the purposes of arbitration was to guarantee an effective settlement within a limited period of time.

42. Mr. ROEHRICH (France) said it would perhaps be possible to find a common ground on the lines of the secretariat proposal, if necessary by simplifying the wording of article 23 (1), which was perhaps much too precise to take account of the rules of different institutions. However, even shorn of some detail, the provision must retain its basic structure and state that the arbitration of a dispute began with an indication of the claim and the response to it. He would also support the Mexican proposal.

43. Mr. LOEFMARCK (Sweden) supported the amendment suggested by the French representative. His delegation would be satisfied with a much vaguer formulation. The Swedish arbitration code merely stated that the arbitrator should give the parties an opportunity to present their cases.

44. Mr. ILLESCAS ORTIZ (Spain) said it was important to maintain article 23 (1). Neither the fundamental principle enunciated in article 19 (3) nor the inclusion in article 34 of a general clause regarding the equitable nature of the procedure would be sufficient to guarantee the necessary even-handed treatment of both parties. Article 23 should state that the parties must submit the facts of the dispute so that the arbitrators could uphold the rights of each party. It was important to specify the stages of the arbitral proceedings down to the award. He felt that the Mexican proposal might well be introduced into article 23 (2).

45. Mr. JARVIN (Observer for the International Chamber of Commerce) supported the views expressed by the French representative on article 23 (1).

46. Mr. ROGERS (Australia) supported the views expressed by the United States and United Kingdom representatives. Regarding the remarks of the representative of Spain, he felt that by inviting the parties to protect themselves against themselves, the Model Law would be paying lip service to party autonomy but actually be tying the parties down hand and foot. Some of the previous speakers had indicated that they knew of no cases when the parties could proceed to arbitration without submitting the material mentioned in

article 23 (1). In response, he would draw attention to the cases of arbitration of disputes relating to claims for damage to goods. In those cases the arbitrators simply inspected the goods on the spot and the parties were not obliged to comply with a minimum standard that might be unsuited to the facts of the case. In conclusion, he joined the Observer for the Chartered Institute of Arbitrators in appealing that once a matter had been submitted to the arbitrators, they should be allowed to do their work as they saw fit and that the principle of party autonomy should be fully implemented.

47. Mr. BOGGIANO (Observer for Argentina) said that in article 23 (2), the parties were granted the right to alter their statements of claim and defence and thereby to alter the subject-matter of the proceedings; that freedom should also be reflected in article 23 (1).

48. Mr. SEKHON (India) said that he agreed with the reasoning of the representative of France. Article 23 (1) should be retained, but if greater flexibility was to be introduced, Mr. Herrmann's suggestion was acceptable.

49. Mr. REINSKOU (Observer for Norway) said that article 23 left it up to the parties or to the arbitral tribunal to decide whether a single or separate time-limit should apply to statements conveying the facts supporting a claim, the points at issue and the relief or remedy sought. Although he could accept the article as it stood, he would prefer it to be redrafted so as to indicate that the matters covered therein were subject to agreement by the parties.

50. Mr. LEBEDEV (Union of Soviet Socialist Republics) said he agreed with the representative of France that it would be illogical to place the words "unless otherwise agreed by the parties" at the very beginning of article 23 (1). He also believed that the concerns expressed by many delegations, including that of the United States, should be taken into account: many countries already had permanent arbitration institutions which had their own rules of procedure governing the requirements for statements of claim and defence, and the Model Law should not conflict unnecessarily with them. Moreover, States must be enabled to reach agreement among themselves, in accordance with the rules of procedure of such permanent arbitration institutions, concerning the contents of statements of claim and defence. The United Kingdom representative also had made a valid point: hundreds of arbitral proceedings were actually conducted daily without recourse to special rules of procedure, and the Model Law should not interfere with that process.

51. He proposed, as a compromise formula, that the words "unless the parties have otherwise agreed on the contents and the form of such statements" should be added at the end of the first sentence of article 23 (1) and that the next sentence should begin with the words "The parties may introduce, along with their statements, ...".

52. Mr. GRAHAM (Observer for Canada) said that the Soviet Union proposals were acceptable, since they would make it possible to deal flexibly with any type of proceedings. They obviated the need for the French amendment.

53. Mr. AYLING (United Kingdom) said that the Soviet Union proposals covered all the cases discussed by the Commission and that his delegation supported them.

54. Mr. ROEHRICH (France) said that the Soviet Union representative had proposed an excellent compromise and his delegation supported it.

55. Mr. TORNARITIS (Cyprus) pointed out that even in countries which applied strict regulations concerning statements of claim and defence, those regulations could be passed over if both parties agreed on some other course.

56. Mr. SCHUMACHER (Federal Republic of Germany) suggested that the words "unless otherwise agreed by the parties" be deleted from article 23 (2) and that a third paragraph, which might read "The provisions foreseen in paragraphs (1) and (2) may be modified by agreement between the parties", should be added.

57. Mr. MATHANJUKI (Kenya) said that article 23 (1) adequately set out minimum requirements for submissions from claimants. He had no objection to the first Soviet Union proposal but believed that whatever procedure was used, the parties must above all have a clear idea of what they were claiming. He understood the second Soviet Union proposal to mean that a party was not necessarily required to annex material to its statement before the proceedings began, as some materials could not be obtained overnight and flexibility was essential.

58. Mr. LAVINA (Philippines) said that the first Soviet Union proposal was acceptable but that the second proposal was unnecessary as the sentence to which it applied was already perfectly clear. He was interested in the proposal made by the representative of the Federal Republic of Germany and would like to see it in writing.

59. Mr. HUNTER (Observer for the International Bar Association) said that the Soviet Union's very practical proposals would be completely acceptable to practitioners.

60. Mr. RAMADAN (Egypt) said that article 23 (1) mirrored article 18 of the UNCITRAL Arbitration Rules, although it was perhaps somewhat less restrictive. If consensus was reached on the Soviet Union proposal, he would prefer the second sentence of article 23 (1) to be redrafted along the lines of article 18 of the UNCITRAL Arbitration Rules, i.e. that the words "The claimant shall submit a statement of claim which indicates the following particulars" should precede the wording suggested by the representative of the Soviet Union.

61. Mr. PENKOV (Observer for Bulgaria) said that the right of parties to change or amend their statements of claim and defence was limited in two cases: when the parties so agreed and when an appropriate decision referring to various reasons and circumstances was taken by the arbitrators.

62. The CHAIRMAN said that, if he heard no objection, he would take it that the Commission wished to approve article 23 (1), as amended by the Soviet Union representative.

63. *It was so decided.*

The meeting rose at 5 p.m.

323rd Meeting

Friday, 14 June 1985, at 9.30 a.m.

Chairman: Mr. SZASZ (Hungary)

The meeting was called to order at 9.45 a.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264)

Article 23. Statements of claim and defence (continued)

Article 23 (2)

1. Mr. SEKHON (India) suggested that the word "relevant" should be inserted before "circumstances" in the last line.

2. Mr. PENKOV (Observer for Bulgaria) said that the autonomy granted to the parties and the discretion granted to the arbitrators were not compatible with the mandatory provisions of the Model Law. For example, the right of each party to be given a full opportunity of presenting his case, as provided for in article 19 (3), implied the right of each party to make any amendments to his claim or defence throughout the proceedings. The provision was, moreover, inconsistent with the single-tier jurisdiction which was characteristic of arbitral proceedings. Greater autonomy might lie with the party occupying the stronger bargaining position, but the award of additional costs was a proper remedy against dilatory tactics. His delegation was, therefore, in favour of omitting the limitation on the right of a party to amend or supplement his claim or defence.

3. Mr. ABLOUL ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) said that, subject to article 32 (2) (b), the arbitral tribunal should not have the power to prevent a party from changing his defence during the proceedings. He suggested that the last three lines of the

paragraph should be amended to read: "However, the arbitral tribunal may consider it inappropriate to allow the amendment of the claim, having regard to the delay in making it or the prejudice to the other party." The words "or any other circumstances" should be deleted because the factors of delay and prejudice included all the circumstances that it was appropriate to cover.

4. Mr. ZUBOV (Union of Soviet Socialist Republics) agreed that the paragraph gave the arbitrators too much freedom; the words "or any other circumstances" should certainly be deleted. He noted that any amendment or supplement submitted by one party would be to his advantage and consequently to the prejudice of the other party. It would, therefore, be more just to grant the parties the right to submit amendments or supplements at any time until the arbitrators announced the termination of the proceedings.

5. Mr. STROHBACH (German Democratic Republic) endorsed the comments made by the representatives of Bulgaria and the Soviet Union. There were many ways for the arbitrators to remedy injustices; in the event of delay, for example, they could make a partial award or increase the costs allowed. The limitation in the second part of the paragraph was thus superfluous and he proposed its deletion; the paragraph should end with the words "arbitral proceedings" at the end of the second line.

6. Mr. SAMI (Iraq) said that the right of the parties to submit amendments or supplements during the proceedings

must be guaranteed until the award was announced. He supported the deletion proposed by the representative of the German Democratic Republic.

7. Mr. NEMOTO (Observer for the Asian-African Legal Consultative Committee) said that the powers of the arbitral tribunal with respect to the matters covered in the paragraph should be limited. He suggested that the words "or supplement" should be inserted after "amendment" in the fourth line.

8. Mr. HOLTZMANN (United States of America) said that he appreciated the concerns expressed by previous speakers, but his delegation was also concerned about questions of practicality and cost. If the limitation in the second part of the paragraph was deleted, the arbitral tribunal would not have the power to prevent abuses of an unlimited right. The way would then lie open to delays, additional costs and injustices. Article 20 of the UNCITRAL Arbitration Rules laid down clear guidelines to prevent possible abuse. Similar provisions were contained in the present text, which his delegation wished to retain in full.

9. Mr. ROEHRICH (France) agreed that the provision should be read in conjunction with articles 19 (3) and 32 (2). The arbitral proceedings should allow not only an initial exchange of claim and defence but also the continuation of the dialogue. Arbitration was above all a matter for the parties and they should be able to submit amendments or supplements when such submissions helped to clarify the subject-matter of the dispute. He was therefore opposed to limiting that right. He proposed the deletion of the reference to prejudice to the other party, which was already covered by article 19 (3), and dropping the formula "or any other circumstances", which was far too broad. The paragraph would then end at the words "in making it".

10. Mr. LOEFMARCK (Sweden) said that, for the reasons given by the representative of the United States, he was strongly opposed to the deletion of the last part of the paragraph.

11. Mr. GRIFFITH (Australia) agreed with the representative of the United States that the text should be on the same lines as article 20 of the UNCITRAL Arbitration Rules.

12. Mr. MOELLER (Observer for Finland) said that he opposed the deletion of the second part of the paragraph, for it was necessary to try to prevent abuses. He could accept the deletion of the words "or any other circumstances" and he could live with the French proposal even though he would prefer retaining the reference to prejudice to the other party.

13. Mr. SZURSKI (Observer for Poland) said that in dealing with cases not covered by agreement of the parties, the Model Law should be flexible and allow them to correct any error that might have been made in a claim or defence. He could therefore agree to the proposal to delete the limitation in the second part of the paragraph. He suggested that the words "until the arbitral proceedings are closed" should be inserted in the opening proviso after the words "by the parties".

14. Mr. SAWADA (Japan) said that the present text was satisfactory, for the arbitral tribunal must retain a degree of control. The only change which his delegation could accept was the deletion of the words "or any other circumstances".

15. Mr. LAVINA (Philippines) said that his delegation supported the French proposal but would be prepared to go along with a majority opinion in favour of dropping the second part of the paragraph.

16. Mr. de HOYOS GUTIERREZ (Cuba) agreed that the right of the parties to submit amendments or supplements should be limited but he did not think that the powers of the arbitrators should be too broad. He could therefore accept the French proposal.

17. Mr. AYLING (United Kingdom) said that the Working Group on International Contract Practices had decided to go into what was, in his delegation's view, excessive detail in the paragraph in order to maintain a balance between the rights of claimants and respondents. The text was a fair compromise and should remain unchanged. The French proposal was superficially attractive but would lead to the undesirable interpretation that the arbitrators were unable to take account of other important matters such as prejudice, costs and new evidence.

18. Ms. VILUS (Yugoslavia) said that her delegation preferred the French proposal, which safeguarded the interests of the arbitral proceedings and of both the parties. As second choice, she could accept the deletion of the words "or any other circumstances". Failing that, the Indian proposal was acceptable.

19. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) said that the paragraph contained two mutually antagonistic considerations: the equality of the parties and the requirements of justice. She supported the French proposal, which struck a fair balance between the two.

20. Mr. RAMADAN (Egypt) said that he understood the practical considerations referred to by the representative of the United States. However, the French proposal seemed to be a satisfactory compromise solution. He noted that article 30 (2) (b) provided a guarantee which should dispel any misgivings about possible abuse by the parties.

21. Mr. GRAHAM (Observer for Canada) agreed with the observer for Greece on the need to strike a balance between two conflicting considerations. The onus would be on the party concerned to demonstrate that a delay was justified. He endorsed the argument of the representatives of the United States and Australia that the Model Law should follow article 20 of the UNCITRAL Arbitration Rules. As to the French proposal, it would be going too far to remove the reference to prejudice to the other party but it might be acceptable to delete the words "or any other circumstances".

22. Mr. ENAYAT (Observer for the Islamic Republic of Iran) said that the present text allowed the arbitrators excessive freedom and he therefore supported the French proposal.

23. Mr. SCHUMACHER (Federal Republic of Germany) and Mr. BARRERA GRAF (Mexico) supported the French proposal.

24. Mr. JOKO-SMART (Sierra Leone) said that if article 19 (3) were accepted—and his delegation accepted it—there should be no difficulty in accepting article 23 (2) as well. He opposed the proposal to delete the second part of the paragraph. That would not be consistent with article 19 (3) and, moreover, it would encourage abuse of the proceedings, since the parties could simply go on submitting amendments without the arbitral tribunal being able to intervene. He was in favour of retaining the references both to delay and to prejudice. Lastly, he had no objection to the compromise of deleting the words "or any other circumstances".

25. Mr. KADI (Algeria) recalled that the Working Group had adopted the present text, but without a majority. He supported the French proposal.

26. Mr. SEKHON (India) opposed the deletion of the reference to prejudice to the other party, since the phrase served a useful purpose. There would be prejudice to the other party if, for example, a party sought an amendment which involved a subject outside the scope of the arbitral agreement.

27. Mr. TANG Houzhi (China) said that the second part of article 23 (2), which reproduced the wording in article 20 of the UNCITRAL Arbitration Rules, seemed to offer too much latitude both to the parties and to the arbitral tribunal. He supported the compromise suggestion to delete only the concluding words "or prejudice to the other party or any other circumstances".

28. Mr. VOLKEN (Observer for Switzerland) supported the view that a better balance was needed between the freedom allowed to the parties and the control exercised by the arbitral tribunal. As for the reference to other circumstances, it could be deleted.

29. The CHAIRMAN said that there appeared to be some support for deleting the whole of the second part of the paragraph, and also considerable support for maintaining the text as it stood, or at least for deleting only the words "or any other circumstances". An intermediate solution had also been proposed, namely to delete the concluding passage "or prejudice to the other party or any other circumstances": the paragraph would thus end with the words "having regard to the delay in making it". He suggested that the Commission might agree to that proposal, which would be a balanced solution.

30. *It was so decided.*

31. Mr. SZURSKI (Observer for Poland) fully supported the decision, on the understanding that the reference to delay was understood to mean delay in submitting a claim.

32. Mr. HOLTZMANN (United States of America) recalled that, at the previous meeting, the Mexican representative had raised the question of counter-claims and that it had been agreed that the Commission should consider it after completing article 23. He understood the Working Group's view to be that a counter-claim was a form of claim and was therefore covered by the right to make a claim. The same applied to defence. He suggested that a sentence should be included in article 23, or wherever else it was relevant, to the effect that "claim" and "defence" included counter-claim and defence to a counter-claim, respectively.

33. The CHAIRMAN suggested that the matter should be left until the Commission had reached the end of the Model Law, in case a separate provision were needed.

34. Mr. BARRERA GRAF (Mexico), referring to his Government's proposal in its comments (A/CN.9/263, p. 55, para. 2), said that he would prefer a reference to counter-claims to be added at the end of article 23 (1). If necessary, however, he would not raise any objection to the matter being dealt with at the end of the Model Law, or to an appropriate reference being included in the report.

35. The CHAIRMAN said that the Mexican representative's point would be noted. It would be better to leave the matter until the end of the Model Law, to see whether it applied to other articles.

36. *It was so decided.*

37. Mr. RUZICKA (Czechoslovakia) said that his Government also had made a proposal (A/CN.9/263, p. 55, para. 3). He was in favour of drafting a separate article, in which it should also be pointed out that such claims could be made only within the scope of the arbitration agreement.

Article 24. Hearings and written proceedings

Paragraphs (1) and (2)

38. Mr. AYLING (United Kingdom) drew attention to the United Kingdom comment (A/CN.9/263/Add.2, para. 18) and to the United States proposal on the same lines (A/CN.9/263, p. 35, para. 1), which he supported. The United Kingdom maintained that, in the absence of agreement between the parties, if either party so requested, the proceedings should be held orally and not in writing.

39. Mr. HOLTZMANN (United States of America) drew attention to the text of his Government's proposal (A/CN.9/263, p. 35, para. 1) and in particular to the words "at any appropriate stage of the proceedings", which had been introduced to meet the concern of a number of representatives about the possibility of a party being able to request oral hearings for unlimited periods and on unlimited occasions. He suggested that an explanation could be included in the article (or possibly in the report) to the effect that nothing therein limited the power of the arbitral tribunal to determine the length of hearings or the stage at which they should be held.

40. Mr. REINSKOU (Observer for Norway) found the wording of article 24 (1) too rigid. He would be satisfied if it were made clear in the Commission's report that article 24 (1) should not be understood as ruling out the possibility of the proceedings being partly oral and partly on the basis of documents. He supported the United States proposal.

41. Mr. MOELLER (Observer for Finland) said that there would seem to be no justification for allowing a party to request oral proceedings if the parties had agreed that there should be only written proceedings. Where the parties had not agreed on either oral or written proceedings, a party should have the right to ask for oral proceedings; he therefore suggested that the existing text of article 24 (1) should be amended to state that the arbitral tribunal "may" (not "shall") decide on the issue of oral proceedings. As for the United States proposal, it appeared suitable for inclusion in the Commission's report, although he would have no objection if members preferred to see it in the text itself.

42. Mr. JARVIN (Observer for the International Chamber of Commerce) agreed with the representatives of Finland, the United States and other countries. He also pointed out that the right to request oral proceedings was not assured in the French version of article 24 (2), which stated that the arbitral tribunal "shall hold" ("organise"), whereas the English text said "may . . . hold". He supported the idea that either party had the right to request oral proceedings.

43. Mr. LEBEDEV (Union of Soviet Socialist Republics), referring to the written comments, including his own Government's (A/CN.9/263, p. 37, para. 5), said that the right of the parties to request oral proceedings was fundamental. In his delegation's opinion, article 24 (1) and article 24 (2) were inconsistent with that basic principle; he therefore supported the United States proposal (A/CN.9/263, p. 35, para. 1), but it would be necessary to consider the drafting. The first sentence specified that either party could make a request "at any appropriate stage of the proceedings" and he suggested

that it should be made clear that when there was no agreement by the parties, the question should be decided at the commencement of the proceedings. Once the principle had been agreed upon, the wording could be left to the drafting committee.

44. Mr. LAVINA (Philippines) said it was a fundamental principle of most legal systems that there could be no proceedings without a hearing—unless, of course, the parties agreed to dispense with it. He therefore supported the United States proposal, which had the merit of combining the present paragraphs (1) and (2) and also of using the mandatory “shall”. He also supported the Norwegian suggestion that the idea of a hearing accompanied by presentation of documents should not be ruled out, and suggested that that idea should be incorporated into the United States proposal.

45. Mr. SZURSKI (Observer for Poland) said that arbitration agreements rarely stipulated that oral proceedings must be held; it was also rare for the parties to request an oral hearing in their statement of claim or defence. Actually, from his experience, he could safely assert that oral proceedings were essential to the proper conduct of international commercial arbitration. He accordingly proposed that the two paragraphs under discussion should be merged and a provision included to the effect that, unless the parties had agreed otherwise, or explicitly renounced oral hearings, the arbitral tribunal would be bound to hold oral hearings for the presentation of evidence or for oral argument. Alternatively, the proposal submitted by Poland and the United States (A/CN.9/263, p. 35, para. 1) could be slightly amended to read “... the arbitral tribunal, having asked the parties, shall hold hearings ...”.

46. Mr. ENAYAT (Observer for the Islamic Republic of Iran) said that he preferred the original text for the reasons given in the secretariat’s comments (A/CN.9/264, p. 54).

47. Mr. ROEHRICH (France) said that his delegation preferred the original text because it could be more easily incorporated into the legal systems of different countries. He proposed that in article 24 (2) the word “may” should be replaced by “shall”, to read “the arbitral tribunal shall ... hold hearings”.

48. Mr. GRAHAM (Observer for Canada) expressed support for the proposal of the United States of America and Poland (A/CN.9/263, p. 35, para. 1), which safeguarded a party’s right to an oral hearing. He could, however, also support the amendment proposed by the French representative to the original text, which would achieve the same result.

49. Mr. BONELL (Italy) pointed out that, under article 24 (2) in its present form, a party who had initially agreed that no hearings should be held might break that agreement at a later stage, in which case the arbitral tribunal would be obliged to comply with his request for oral hearings. He therefore supported the proposal by the United States and Poland, possibly with the clarification suggested by the United States representative.

50. Mr. GRIFFITH (Australia) supported the United States proposal.

51. Mr. RAMADAN (Egypt) said that the United States proposal was too wide in scope. The Arabic translation of article 24 read: “the arbitral tribunal *may* ... hold hearings”.

52. Mr. LOEFMARCK (Sweden) supported the United States proposal. The United States representative’s amend-

ment to his proposal, concerning the limitation of the length of oral hearings, should be included in the report rather than in the text of the article. Admittedly, it would be preferable to decide at an early stage whether the proceedings should be oral or written, but it would be wrong to take away the arbitral tribunal’s right to decide on such a question at any stage.

53. Mr. SAMI (Iraq) said that the present wording of article 24 (1) limited the freedom of the parties to choose their presentation of the case. It was important to observe the spirit of the Model Law and give each party equal treatment and the opportunity to present his case.

54. Mr. AYLING (United Kingdom) said that his delegation could accept the United States proposal, with or without the subsequent amendment proposed by the United States representative, or the original text with the word “may” replaced by the word “shall”. However, as the Italian representative had pointed out, a party should not be allowed to request an oral hearing if it had previously agreed that no such hearing should be held.

55. Mr. MTANGO (United Republic of Tanzania), supported by Mr. JOKO-SMART (Sierra Leone), said that a party who had originally agreed that no oral hearing should be held might subsequently decide that one was necessary after all. The word “may” in the original text gave the arbitral tribunal the power to decide in that case whether the request was justified.

56. Mr. ABUL ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) said that the original text would be preferable if the word “may” was replaced by “shall”.

57. Mr. BARRERA GRAU (Mexico) agreed with the Tanzanian representative that the word “may” should be retained. He could also support the United States proposal if the word “shall” were used.

58. Mr. SCHUMACHER (Federal Republic of Germany) said that the United States proposal was clearer than the original text and still gave the arbitral tribunal the power to prevent any attempt to delay the proceedings.

59. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) supported the United States proposal because it avoided the problem to which the Italian representative had drawn attention.

60. Mr. HOLTZMANN (United States of America) said that many speakers had stressed a party’s right to request an oral hearing at any stage, in which case article 24 (2) should read “... the arbitral tribunal *shall* ... hold hearings”. However, he did not consider that a party should have the right to demand an oral hearing if it had been stated in the arbitration agreement that no such hearing should be held. The United States proposal was worded accordingly.

61. Mr. TORNARITIS (Cyprus) expressed a preference for the original text with the oral amendments which had been proposed.

62. Mr. TANG Houzhi (China), Mr. KADI (Algeria) and Mr. OLUKOLU (Nigeria) expressed a preference for the original text of article 24.

The meeting rose at 12.30 p.m.

324th Meeting

Friday, 14 June 1985, at 2 p.m.

Chairman: Mr. SZASZ (Hungary)

The meeting was called to order at 2.05 p.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264;
A/CN.9/XVIII/CRP.10)

Article 24. Hearings and written proceedings (continued)

Article 24 (1) and (2) (continued)

1. The CHAIRMAN said that, if he heard no objection, he would take it that the Commission wished to transmit the text of paragraphs (1) and (2) to the drafting committee with a request that it incorporate in them the following ideas: that the parties should be free to decide whether an oral hearing should take place or not; that if not expressly prohibited by the parties, either party had a right to an oral hearing upon request; that if the parties took no decision on the matter and neither applied for an oral hearing, the arbitral tribunal could decide how the proceedings were to be conducted.

2. *It was so agreed.*

3. The CHAIRMAN noted that a number of delegations had endorsed the view expressed by the Tanzanian representative (A/CN.9/SR.323, para. 55), that even if the parties had agreed at one stage not to hold oral hearings, they should be entitled to request the arbitral tribunal to hold them at a later stage. He thought the wording of article 19 (3) might be used to give effect to that view in extreme or marginal cases.

Article 24 (3)

4. Mr. LEBEDEV (Union of Soviet Socialist Republics) drew attention to his delegation's written suggestion in A/CN.9/263 (p. 37, para. 9) for clarifying the meaning of the words "for inspection purposes". He hoped the drafting committee would give it serious consideration.

5. The CHAIRMAN said that, with that comment in mind, he would take it that article 24 (3) was approved.

6. *It was so agreed.*

Article 24 (4)

7. Mr. GRAHAM (Observer for Canada) drew attention to the words "or other document" and said it was unclear what documents they covered. He presumed that the intention was to enable the parties to see any texts the arbitral tribunal used in making its decision, including official publications, dictionaries, glossaries and weather reports; if so, that should be made clear.

8. Mr. LAVINA (Philippines) said that he shared the view expressed by the Observer for Canada and also had reservations about the reference to an "expert report".

9. Sir Michael MUSTILL (United Kingdom) said that the purpose of the text should be to ensure, first, that the arbitral tribunal did not rely on documents upon which the parties had not had an opportunity to comment and that, secondly, such documents were transmitted to them before the tribunal

made its decision. The words "may rely" were ambiguous and should be amended to make it clear that documents must be transmitted to the parties before the decision was taken.

10. Mr. KADI (Algeria) said it was unclear whether the words "other document" covered recordings and films.

11. Mr. HOLTZMANN (United States of America) said that, while the first sentence of the paragraph was based on article 15 (3) of the UNCITRAL Arbitration Rules, the second went beyond them. The words "or other document" might be construed as requiring arbitrators to communicate results of their library research to the parties before making an award, for example. The text should not preclude tribunals from doing what they normally did in making decisions: consulting statistics, dictionaries, and so on. He would prefer the second sentence to be deleted altogether, but if it was retained, the words "or other document" should be excised. The reference to "expert report" might be dealt with when the Commission considered article 26.

12. Mr. VOLKEN (Observer for Switzerland) inquired whether, if the words "or other document" were deleted, a party would be able to provide the arbitral tribunal with documents which contained professional secrets which it did not wish the other party to see.

13. Mr. HOLTZMANN (United States of America) said that under the first sentence, all documents supplied to the arbitral tribunal by one party must be communicated to the other party. It was up to the party concerned and the arbitral tribunal to find some means of permitting professional secrecy to be respected. The deletion of the second sentence would not affect the preservation of professional secrecy, however.

14. Mr. ENAYAT (Observer for the Islamic Republic of Iran) said that he advocated leaving the text unaltered; it would have no dangerous consequences, and the parties needed to know on what basis the arbitral tribunal took its decision.

15. The CHAIRMAN said that there was no dispute about the general principle set out in the first sentence and it was clear that it did not cover reports of experts appointed by the tribunal. The problems with the second sentence could be resolved by requesting the drafting committee to delete the phrase "or other documents" unless they could characterize, in any way other than the first sentence did, the materials which might be used by the arbitral tribunal. The main principle, however, was that even if that phrase was deleted, the parties must be given an opportunity to study all documents upon which the arbitral tribunal might rely in making its decision.

16. Mr. ROEHRICH (France) said that he fully endorsed the Chairman's last comment and thought that it could usefully be incorporated in the text.

17. The CHAIRMAN said that he thought it would be sufficient to reflect it in the summary record. If he heard no

objection, he would take it that the Commission agreed with the procedure he had proposed.

18. *It was so agreed.*

Article 34. Application for setting aside as exclusive recourse against arbitral award (continued)

19. The CHAIRMAN observed that there were three problems that had to be resolved. The first was the issue of misconduct, which was addressed by a proposal from the United Kingdom in A/CN.9/XVIII/CRP.10; the second was the territorial scope of application of the article; and the third was how the article was to be aligned with the wording of article 19 (3).

20. Mr. MTANGO (United Republic of Tanzania) said that it must be made clear that considerations other than those set out in article 34 (2) could be grounds for setting aside an award. His delegation proposed the insertion of a reference to other justifiable grounds.

21. Sir Michael MUSTILL (United Kingdom), introducing his delegation's proposal (A/CN.9/XVIII/CRP.10), said that a problem had arisen in the Commission because the words "public policy" were an inaccurate rendering of the term "*ordre public*", which conveyed a wider notion of procedural injustice. It was necessary to find an expression which would be meaningful to jurists throughout the entire world but not so general as to permit totally unrestricted access to the courts, with the attendant possibility of interminable delays.

22. His delegation proposed two alternative solutions to the problem. Alternative 1 referred to "natural justice" and was the best, in his opinion. Many common law countries were well acquainted with the notion and it had the advantage of not requiring retranslation into French, as it was an acceptable rendering of "*ordre public*". However, because the notion of natural justice might be meaningless in some legal systems, he had sought a formulation that was more explicit yet less linked to a particular legal system. Taking article 52 of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States as his inspiration, he had used, in alternative 2, the expression "fundamental rule of procedure". But that might be construed as referring to a number of things, for example, something established by the Model Law, a standard set of rules of an arbitration institution, or a local code of civil procedure, whereas it was intended to denote a fundamental underlying rule of procedure common to all legal systems. He therefore put alternative 2 forward, with the word "rule" replaced by either "principles" or "standards".

23. Mr. BOGGIANO (Observer for Argentina) said that while he agreed that the reference to "*ordre public*" had to be expanded to comprehend procedural aspects, both of the United Kingdom's proposals would be ambiguous in Spanish. He therefore suggested that the article should refer to "due process", which was a concept accepted in both civil law and common law. The language used in article 19 (3), "shall be given a full opportunity of presenting his case", might also be a means of conveying the concept of natural justice.

24. Mr. LOEFMARCK (Sweden) said that his delegation could accept alternative 2, with the word "principles" replacing the word "rule". Referring to alternative 1, he said that the concept of natural justice had long ago been abandoned in Sweden and it was difficult for him to see it as being covered by the expression "*ordre public*".

25. Mr. MOELLER (Observer for Finland) said that he understood the concerns which motivated the United Kingdom proposal even though his delegation saw no need for such a provision. The concept of natural justice mentioned in alternative 1 was unknown in his country; with regard to alternative 2, he would prefer it with the word "principles".

26. Mr. BONELL (Italy) said that in its written comments (A/CN.9/263, p. 47, para. 8) his delegation had proposed including in the grounds for attacking an award the grounds provided in the Italian Code of Civil Procedure for review of an arbitral award. Very similar grounds had been discussed by the United Kingdom in its general observations on court intervention on the grounds of procedural injustice (A/CN.9/263/Add.2, pp. 8-10). In his view, however, the proposal by the United Kingdom in document A/CN.9/XVIII/CRP.10 did not cover the matter fully.

27. His delegation would like to suggest an alternative solution. Article 25 of the Uniform Law annexed to the 1966 European Convention Providing a Uniform Law on Arbitration contained roughly what was in article 34 of the Model Law, plus, in paragraph (3), the very important provision that an award could also be set aside if it was obtained by fraud, if it was based on evidence that had been declared false by a judicial decision having the force of *res judicata* or on evidence recognized as false, or if, after it had been made, there was discovered a document or other piece of evidence which would have had a decisive influence on the award and which had been withheld through the act of the other party. A second important point was that article 28 of that Convention set a period of five years for a setting-aside application based on one of those additional grounds. Clearly, an appropriate period in such cases should extend far beyond three months, even if not for as much as five years. His main concern, however, was that the United Kingdom proposal seemed to cover only some of the grounds he had mentioned, even in its widest interpretation. If, at so late a stage, the Commission was not in a position to take up his delegation's suggestion, he hoped it would be appropriately reflected in the report.

28. Mr. ROEHRICH (France) said that his delegation had originally been in favour of the text of the Working Group. It appreciated the problem faced by the United Kingdom and other delegations, however, and was therefore ready to accept the second proposed alternative, with the word "principle" substituted for the word "rule". It would have difficulty in accepting the Italian delegation's suggestion at the present stage of the discussion. If the United Kingdom proposal was accepted, he took it that that would exhaust the list of grounds to be specified for setting aside an award. He felt that the link between article 34 and article 19 (3) of the Model Law was a technical rather than a substantive question. It was important to ensure that there were no contradictions between their provisions.

29. Mr. DUCHEK (Austria) said that his delegation favoured the idea of bringing the notion of procedural "*ordre public*" into the article and was grateful to the United Kingdom delegation for attempting to do that. Since Austria was a civil law country, his delegation would prefer the second alternative, but with the word "principle". The anxieties of the Italian delegation constituted an important question, which should be discussed separately.

30. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that his delegation was well aware of the difficulties which the representative of the United Kingdom was trying to solve. In some countries the notion of natural justice was not used, in others that of "*ordre public*" or "public policy"; and there

were some countries where neither notion was used as a legislative technique. In international conventions, however, the use of the terms "*ordre public*" and "public policy" had proved quite satisfactory to the international community, even though it was extremely difficult to define them. He felt that the problems in the present case were covered by the reference to public policy in paragraph (2) (b) (ii). If an expression such as "fundamental principles of procedure" was adopted, it would not seem certain whether it referred to the rules contained in the Model Law or to rules laid down in national codes of civil procedure.

31. If the list of grounds for setting aside an award specified in article 52 of the Washington Convention on the Settlement of Investment Disputes was compared with the list in article 34 of the draft Model Law, it would be seen that the Model Law grounds were much broader. Given the very varied conceptual approaches to the issue of court control over arbitral proceedings and awards, the standards set in the Model Law constituted a more or less acceptable compromise; the expansion, by some sort of general provision, of the list of grounds for setting aside an award which the Model Law already contained would upset that balance and offer the possibility of too broad and varied an interpretation of the article in different countries. His delegation accordingly felt that the draft was satisfactory as it stood. If a majority favoured adding a provision referring to fundamental principles of procedure, it would have to be determined what procedure was meant. For example, article 25 (2) (g) of the Uniform Law annexed to the 1966 European Convention referred to "disregard of any other obligatory rule of the arbitral procedure", thus not to procedure in general but specifically to arbitral procedure. The Commission did not have in mind, in framing the Model Law, the assimilation of judicial and arbitral procedures.

32. Mr. HOLTSMANN (United States of America) said that his delegation too was grateful to the representative of the United Kingdom for his efforts to solve a difficult problem. Unfortunately, though, it found the first alternative unacceptable, because the term "natural justice" was known in the United States as a philosophical norm but it was not found in its legislation. The second alternative also constituted a problem for his delegation. For example, the reference to fundamental rules or principles of procedure might not cover corruption on the part of a member of the tribunal, for that was mentioned separately in the 1965 Washington Convention. There was some question, therefore, as to what that reference meant.

33. Perhaps the rules really at issue in the United Kingdom proposal were those embedded in the so-called Magna Carta of arbitral proceedings, article 19 (3) of the Model Law. His delegation agreed with the Observer for Argentina that article 19 (3) seemed to express the principle of natural justice, but could not support his proposal to use the term "due process" in article 34, since it would be subject to varying interpretations according to the jurisdiction concerned. The United States associated itself fully with the comments of the Soviet Union. In so far as it was necessary to have a test of public policy, that test was included in paragraph (2) (b) (ii), which in his delegation's view contemplated such things as corruption on the part of the arbitrators. Since concerns of public policy were already provided for in article 34 and would cover such things as forgery and bribery, and since the principles of procedure could not be better expressed than they were in article 19 (3), it would perhaps be best to leave paragraph (2) (a) (ii) as it stood but include in it a specific reference to article 19 (3). His delegation would, moreover, strongly advocate making 19 (3) a separate article and placing it in a prominent position.

34. Mr. GRAHAM (Observer for Canada) said that his delegation would prefer the first of the United Kingdom's alternatives. He felt that the term "natural justice" was properly conveyed in French as "*ordre public*" and offered an acceptable solution to the problem of catering for differing concepts while maintaining a term that was well recognized in international law. In judicial proceedings in Quebec, the two terms were used as being more or less equivalent: "*justice naturelle*" corresponded to "*ordre public*". His delegation would, however, be prepared to accept the second alternative if "principle" was substituted for "rule". There was no need to refer explicitly to corruption, as the 1965 Washington Convention did, since that would be covered by the reference to public policy in paragraph (2) (b) (ii). His delegation favoured an addition in paragraph (2) (a) (ii) on the lines proposed by the United Kingdom.

35. Mr. SAWADA (Japan) said his delegation would have difficulty in accepting the Italian delegation's suggestion, particularly in regard to the use of new evidence in the setting-aside procedure. It could, however, accept the United Kingdom proposal and would prefer the second alternative, with the use of the word "principle" or "standard", or possibly the expression "fundamental procedural requirement".

36. Mr. GRIFFITH (Australia) said that while his delegation found the term "natural justice" perfectly acceptable, it appreciated the difficulties it presented for other delegations. The second United Kingdom alternative would probably cover the necessary situations, including—and he hoped that would be generally agreed, if not explicitly stated—such obvious cases as awards attained through corruption or false evidence and the other situations listed in the United Kingdom's written comments (A/CN.9/263/Add.2, p. 9, para. 32). If not, it might be clearer to use a phrase such as "serious departure from a fundamental principle of justice"; that would obviously embrace cases of fraud, which might not be covered by a narrow interpretation of the term "procedure".

37. On another point, it could well be that, in the interest of finality, the parties to an arbitration agreement might not wish to place themselves under the jurisdiction of the court. The Model Law should therefore make provision for them to contract out of judicial supervision, both for setting aside and for enforcement, if they so wished. The words "unless otherwise agreed by the parties" should therefore be added to the relevant provisions.

38. Mr. OLIVENCIA (Spain) said that although he understood the reasons for the United Kingdom's proposal, he preferred the existing text of paragraph (2) (a) (ii). If it was to be inserted at all, alternative 1 would be more appropriate in paragraph (2) (a) (iv), which dealt with the arbitral proceedings, than in paragraph (2) (a) (ii); however, it was too abstract and made reference to a concept alien not only to the Spanish legal system but apparently to many others. *Ordre public* was a concept more generally acceptable than natural justice and already appeared in paragraph (2) (b) (ii), but with reference to "the award"; there was some doubt, therefore, as to whether the ground of conflict with *ordre public* could be invoked in regard to all the steps of the arbitral proceedings during which irregularities might have occurred. It was desirable to make specific mention somewhere in paragraph (2) (a) of procedure inconsistent either with the law or with *ordre public*.

39. Mr. HERRMANN (International Trade Law Branch) said that all the known cases under the 1958 New York Convention in which the violation of the public policy clause had been

invoked had concerned violations of procedure. There was a clear understanding that the reference to the award in subparagraph (b) (ii) covered impropriety, such as corruption and fraud, in the manner in which the award had been reached. Such matters were not regarded as minor procedural defects.

40. Mr. LAVINA (Philippines) said that he was unable to accept the United Kingdom's proposal, particularly in regard to alternative 1. Although the Philippine legal system included elements of civil law, common law and Muslim law, the term "natural justice" was not employed. He associated himself with the comments of the Soviet Union representative.

41. The CHAIRMAN, speaking as the representative of Hungary, said he feared that any amendment would result in destabilizing a text which was well balanced in respect of judicial control. The Model Law must be viewed as a whole. The validity of the examples cited by the United Kingdom in its written comments (A/CN.9/263/Add.2, p. 9, para. 32) was generally recognized, but all serious defects, including those of procedure, would be covered by the concept of *ordre public* and separate provision for procedural defects was therefore unnecessary. In fact, the wording of the proposal in document A/CN.9/XVIII/CRP.10 covered the United Kingdom's written examples much more loosely than did the concept of *ordre public*. He suggested that paragraph (2) (a) should stay as it was, with appropriate explanations in the report.

42. Mr. VENKATRAMIAH (India) said his delegation had serious doubts as to whether the United Kingdom's first alternative would meet its purpose. His delegation would be prepared to accept alternative 2, provided the word "principle" was substituted for the word "rule" and there was some clarification as to the meaning of the word "fundamental".

43. Mr. VOLKEN (Observer for Switzerland) said that in Swiss legislation the point at issue was covered by the notion of *ordre public procédural*. He felt that the present text was adequate. If something more general was required, appropriate wording might perhaps be found along the lines of the United Kingdom's alternative 2. However, it would be incorrect for paragraph (2) (a) to contain both a list of specific cases and also a general expression covering the same points. If the Commission accepted alternative 2, it must delete the words "or was otherwise unable to present his case" in paragraph (2) (a) (ii).

44. Mr. MTANGO (United Republic of Tanzania) said he had previously felt that the present wording did not cover all cases, but it seemed to be the view of many delegations that all justifiable cases for setting aside the award came under the concept of public policy. If that was so, that broad interpretation should be duly reflected in the report, so that it did not appear that the Commission had considered all possible cases.

45. He agreed with the United States representative that article 19 (3) should appear as a separate article in an appropriate place in the Model Law.

46. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) said that Greek law provided for setting aside an award if it was contrary to *ordre public*, a concept which would cover most of the examples cited by the United Kingdom in its written comments (A/CN.9/263/Add.2, p. 9, para. 32). Her delegation would therefore have supported the inclusion of at least some of those examples in the list of grounds for setting aside mentioned in paragraph (2) (a), particularly the case where fresh evidence was disclosed. As

far as the United Kingdom alternatives were concerned, her delegation would have great difficulty in accepting the idea of natural justice as equivalent to *ordre public*; she understood natural justice to be a much broader, abstract concept, generally used in contradistinction to positive or applied law. She would therefore prefer alternative 2.

47. Mr. RAMADAN (Egypt) said that if *ordre public* was interpreted in a broad sense there would be no need to amend paragraph 2 (a) (ii), which he was in favour of keeping as it was, with appropriate explanatory paragraphs in the report. A possible course might be to amend subparagraph (a) (ii) to read "... or if there has been a serious departure from the fundamental principles of arbitral proceedings or the party making the application was otherwise unable to present his case".

48. Mrs. VILUS (Yugoslavia) said that she favoured the existing text, for the reasons given by the Soviet Union representative. She also supported the proposal to make article 19 (3) a separate article, as in that form it would have an impact on other articles.

49. Mr. TANG Houzhi (China) said that, of the various possible options for paragraph (2) (a) (ii), his delegation would prefer either the existing text as it was, or the existing text with the words "or was otherwise unable to present his case" replaced by language from article 19 (3). The question of public policy being a very complicated one, he suggested that in paragraph (2) (b) (ii) the words "the public policy of this State" should be replaced by the words "the fundamental principles of law of this State".

50. Mr. BARRERA GRAF (Mexico) said that he preferred the existing text of paragraph (2) (a) (ii). The problem which had given rise to the Commission's request to the United Kingdom delegation to submit an amendment to that provision actually lay in the use of the expression "public policy" in paragraph (2) (b) (ii). *Ordre public* was a notion broad enough to include the examples cited by the United Kingdom in its written comments and some of those mentioned by the Italian representative. It was unnecessary to specify in the text itself whether "public policy" corresponded precisely to "*ordre public*". If article 34 was accompanied by explanatory comments, they should deal with the points which delegations considered were not covered by the list in paragraph (2) (a). As a second choice, his delegation could accept the United Kingdom's alternative 2, with the word "rule" replaced by the word "principle".

51. Mr. SCHUMACHER (Federal Republic of Germany) said that, in the case of violations of fundamental principles of procedure, such as conduct constituting corruption and falsification of documents, the time-limit specified in paragraph (3) was inadequate. He wholeheartedly supported the comments made on that point by the Italian representative.

52. Mr. STROHBACH (German Democratic Republic) favoured the existing text. He had difficulties with both of the United Kingdom's alternatives in view of their interpretation and their possible consequences for the structure of articles 34 and 36. Article 34 should give an exhaustive list of reasons for setting aside an award and should not contain an escape clause. Nor could he support the suggestion of the Italian representative. The German Democratic Republic, by acceding to the 1972 Moscow Convention on Arbitration of Civil Law Disputes, had given up the concept of general judicial review of arbitral awards and was not disposed to return to it.

53. Mr. de HOYOS GUTIERREZ (Cuba) said that, for the reasons stated by the Hungarian delegation, he was in favour of article 34 as it stood. Furthermore, the concept of natural justice was alien to civil law systems.

54. Mr. TORNARITIS (Cyprus) observed that although "public policy" did not exactly correspond to "*ordre public*", nevertheless the two expressions often conveyed the same meaning. The notion of natural justice was known in Cyprus, which had a common law system, but it was not known in all countries, although the principles it enshrined were recognized by all. He suggested that either the text of the Model Law or the report should contain an explanation that the notion of conflict with public policy included any contravention of the fundamental principles of natural justice.

55. Mr. JARVIN (Observer for the International Chamber of Commerce) said that his organization was in favour of some addition to the text to deal with serious procedural defects not at present covered by the Model Law. Both the alternatives proposed by the United Kingdom were vague, but he preferred alternative 2, provided it spoke of a fundamental principle of procedure. Arbitral proceedings should not be treated in the same way as judicial proceedings, and that should be made clear by an addition to alternative 2. He would like to go even further: the Commission was in the process of establishing a new concept of setting aside an award in international arbitration. It must therefore ensure that national courts did not apply standards which opened the door to the acceptance of setting-aside grounds based on particular local conditions or requirements. Alternative 2 should be limited to internationally recognized grounds, either by specific wording in the text or by an explanatory comment in the report.

56. Sir Michael MUSTILI (United Kingdom) said that he had understood his mandate to be to draft a form of words which would complement paragraph (2) (b) (ii) and be placed in

paragraph (2) (a), in order to make clear precisely what was meant. He wished to repeat the point made by the Spanish representative: one of the main reasons for uncertainty as to whether paragraph (2) (b) (ii) was sufficient—and that would be particularly so in the United Kingdom—lay in the conjunction of the expression "public policy" and the word "award"; that had been taken as meaning that the question of conflict with public policy might relate solely to the award and not to the procedure leading up to it. He acknowledged the force of the Soviet Union representative's comment on procedural principles. It had never been his intention to suggest that a supervisory court, when considering the acceptability of procedure, should address itself at all to national systems of law. If some amendment was required to make that clear, he would certainly not object to it.

57. The CHAIRMAN said it appeared there was a general desire that paragraph (2) (a) should be an exclusive list of grounds for setting aside an award. Most speakers had stated that their first preference was to leave article 34 as it stood, but many had selected alternative 2 of the United Kingdom's proposal as the second best option, with certain amendments. Some of them had been in favour in any case of taking some action to meet the preoccupations of those holding the same views as the United Kingdom delegation. He would therefore like to propose a solution which reflected the general view as far as the text was concerned but also accommodated the opinion that article 34 should cover elements which at present it did not. He felt that could be done by adding to paragraph (2) (a) the full text of article 19 (3). It was a matter of drafting whether the text of article 19 (3) should appear as a separate subparagraph of article 34 (2) or should be added to the list already drawn. In addition, the commentary should state that most speakers had expressed the view that the term "public policy" covered cases of fraud, corruption and other serious violations of procedure.

The meeting rose at 5.10 p.m.

325th Meeting

Monday, 17 June 1985, at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 9.35 a.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264)

Article 25. *Default of a party*

Article 25 (a) and (b)

1. Mr. JOKO-SMART (Sierra Leone) said that the words "without showing sufficient cause" in the introductory sentence of the article gave rise to two problems. The first was whether "sufficient cause" was to be shown to the other party or to the arbitral tribunal. The second problem related to the time factor. If cause was to be shown before the time-limit set in article 23 (1), sufficient time must be allowed for the other party to comply with that time-limit. Permitting cause to be shown after the time-limit was tantamount to extending the time agreed by the parties. It might be best to delete the words "without showing sufficient cause".

2. Mr. MTANGO (United Republic of Tanzania) said that the phrase should be made clearer rather than deleted. The addition of the words "to the arbitrators" might solve the problem.

3. Mr. de HOYOS GUTIERREZ (Cuba) said that the phrase should be retained because the parties should have an opportunity to state reasons for non-compliance with article 23 (1).

4. Mr. GRIFFITH (Australia) said that the arbitral tribunal should have a clear power to order an extension in appropriate circumstances. He suggested the deletion of the phrase "without showing sufficient cause" and the insertion of the words "or otherwise ordered by the arbitral tribunal" before the word "if".

5. The CHAIRMAN said that the Australian suggestion would give the arbitral tribunal explicit discretionary power. If that was the Commission's wish, the word "shall" should be replaced by "may" in subparagraph (b), and the end of subparagraph (a) should be amended to read "the arbitrators may terminate the proceedings". The words "without showing sufficient cause" would then become superfluous and could be dropped.

6. Mr. ROEHRICH (France) said that the words "without showing sufficient cause" already gave the arbitral tribunal

sufficient discretionary power and met the point made by the representative of Australia. The word "shall" should remain in both subparagraphs (a) and (b).

7. Mr. GOH (Singapore) said that the provision should be clearer concerning the discretionary power of the arbitral tribunal to terminate the proceedings.

8. Mr. HOLTZMANN (United States of America) said that the phrase "without showing sufficient cause" should remain in the text and should be understood to imply "in the view of the arbitral tribunal". The Australian suggestion perhaps made the point clearer. The Chairman's suggestion to replace "shall" with "may" in subparagraphs (a) and (b) would amount to a substantive change in the thrust of the Model Law.

9. Mr. AYLING (United Kingdom) agreed that the phrase "without showing sufficient cause" implied "to the arbitrators". It was odd that the phrase governed subparagraph (a) but also subparagraph (b). The aim of subparagraph (b) was that the arbitrators should not have discretion but must continue the proceedings without the statement of defence being communicated.

10. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said he understood the provision to mean that the arbitrators always had the discretion, for example, to grant the respondent a period of grace if his failure to serve his papers on time was not a wilful act and caused no undue delay in the proceedings.

11. The CHAIRMAN suggested that the Commission's report should make it clear that the words "without showing sufficient cause" implied "to the arbitrators" and that the intention was to give the arbitrators a degree of discretion and flexibility.

12. *It was so agreed.*

13. The CHAIRMAN said that it would cause great difficulties if the Commission attempted to draft wording to cover the point made by the representative of Sierra Leone.

14. Mr. HOLTZMANN (United States of America) pointed out that a party might fail to meet the time-limit set in article 23 (1) and then promptly thereafter give a valid reason for that failure.

15. Mr. IOKO-SMART (Sierra Leone) pointed out that sufficient cause might be shown after the time-limit, when the arbitral tribunal had already terminated the proceedings pursuant to subparagraph (a). In that case the party concerned should have the opportunity to re-open the proceedings.

16. The CHAIRMAN said that in such a case the party could begin new proceedings. He suggested that the Commission should not try to deal with the point in the Model Law.

17. *It was so agreed.*

18. Mr. SCHUMACHER (Federal Republic of Germany) drew attention to his Government's written comment on subparagraph (b) (A/CN.9/263, p. 37, para. 1). The subparagraph could not be interpreted to mean that silence on the part of the respondent would not result in any disadvantage to him. That was the common view in the Commission, and the text should make it clear.

19. Mr. ROEHRICH (France) endorsed the comments made by the representative of the Federal Republic of Germany.

20. The CHAIRMAN suggested that, if the Commission was agreed on the meaning of the subparagraph, it should be submitted to the drafting committee for rewording.

21. *It was so agreed.*

Article 25 (c)

22. Mr. LEBEDEV (Union of Soviet Socialist Republics) drew attention to his delegation's written proposal concerning subparagraph (c) (A/CN.9/263, p. 38, para. 3). The proposal should in fact read "may, or at the request of the other party must, continue the proceedings" and not "may, and at the request . . .". The point was that it would be unjustified to give the arbitral tribunal full discretion in such cases.

23. Mr. MOELLER (Observer for Finland) supported the Soviet Union proposal.

24. Mr. MTANGO (United Republic of Tanzania) said that he was not opposed to the Soviet Union proposal but it might be helpful to insert the words "within reasonable time" after "documentary evidence".

25. The CHAIRMAN noted that the words "within reasonable time" could apply only to the production of documents and not to an appearance at a hearing.

26. Mr. SZASZ (Hungary) said that the text implied that the time-limit for the production of documents would be set by the arbitral tribunal; it could be assumed that it would be a reasonable one.

27. The CHAIRMAN suggested that the report should make it clear that documentary evidence was to be produced within the period set by the arbitral tribunal or, if no period had been set, within reasonable time.

28. Mr. HOLTZMANN (United States of America) said that the point made by the representative of the Federal Republic of Germany concerning subparagraph (b) applied equally to subparagraph (c), which should also be sent to the drafting committee.

29. The CHAIRMAN said that in his opinion the point made by the Federal Republic of Germany applied only to subparagraph (b). The Soviet Union proposal for subparagraph (c) gave the arbitral tribunal wide discretion.

30. Mr. SAMI (Iraq) said that his delegation could not accept the Soviet Union proposal because the party requesting the continuation of the proceedings might take unfair advantage of the failure of the other party to submit documentary evidence. There might be good reasons for such failure, and decisions concerning continuation of the proceedings should rest only with the arbitral tribunal. Furthermore, the Soviet Union proposal was in contradiction with the proviso "without showing sufficient cause" at the end of the introductory sentence. That proviso gave the tribunal some discretion, whereas under the Soviet Union proposal it would have to continue the proceedings if so requested by one of the parties.

31. Mrs. RATIB (Egypt) endorsed the second point made by the representative of Iraq.

32. The CHAIRMAN said that in his view there was no contradiction, since the introductory sentence governed all three subparagraphs. Under the Soviet Union proposal, the tribunal would be bound to comply with a request for continuation of the proceedings made by one of the parties under subparagraph (c) only if the defaulting party had not shown sufficient cause.

33. Mr. LEBEDEV (Union of Soviet Socialist Republics) agreed with the Chairman that there was no contradiction but said that, if a number of delegations were opposed to his proposal, he would not press it.

34. Mr. ABOUL-ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) said that he could not accept any amendment to the present text.

35. Mr. ENAYAT (Observer for the Islamic Republic of Iran) said that his delegation preferred the existing text, since the Soviet Union proposal would limit the discretionary powers of the arbitral tribunal.

36. Mr. LAVINA (Philippines) said that his delegation supported the Iraqi position.

37. The CHAIRMAN suggested that, since the representative of the Soviet Union did not press his amendment, the Commission should retain the existing text of subparagraph (c).

38. *It was so agreed.*

Article 26. Expert appointed by arbitral tribunal

39. Mr. LEBEDEV (Union of Soviet Socialist Republics), speaking on article 26 (1), said that the parties should decide before the setting up of the arbitral tribunal whether they wished to allow the appointment of experts or not. An arbitrator might of course not consider himself competent in a particular area and might wish to rely upon the advice of an expert. If the parties did not wish an expert to be appointed, the arbitrator could resign, but the resultant delay would not be in the parties' best interests. He proposed that the opening sentence of the paragraph should be amended to read "Unless otherwise agreed by the parties before the arbitrators are appointed, ...".

40. The CHAIRMAN pointed out that parties could withdraw from the arbitral proceedings at any stage if they were not satisfied with the expert appointed by the arbitral tribunal.

41. Mr. MTANGO (United Republic of Tanzania) said that article 26 should be maintained in its present form since it gave the parties freedom to decide at any stage of the proceedings whether an expert should be appointed.

42. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) agreed with the Soviet Union representative that arbitrators should know in advance whether they would have the right to obtain the assistance of an expert. That was no danger to the parties since under the Model Law they would have an opportunity to interrogate the expert appointed by the tribunal.

43. Mr. AYLING (United Kingdom) said he preferred the present text of article 26. With regard to the point raised by the Soviet Union representative, he himself felt that in most cases the parties would avoid a decision which might force the

resignation of an arbitrator, because of the delay and expense which that would cause.

44. Mr. ROEHRICH (France) also favoured retaining article 26 as it stood.

45. Mr. PAULSSON (Observer for the Chartered Institute of Arbitrators) expressed support for the present text of article 26, which his organization had followed in drawing up the rules of the London Court for International Arbitration (1985). It was also consistent with the IBA Supplementary Rules Governing the Presentation and Reception of Evidence in International Commercial Arbitration (1983). In practice, parties rarely agreed that experts should not be appointed.

46. Mr. OLUKOLU (Nigeria) said that the present text of article 26 gave the parties the required degree of freedom and should be retained.

47. Mr. LAVINA (Philippines) proposed that the words "Unless otherwise agreed by the parties" should be deleted; the parties should rely upon the arbitral tribunal to appoint experts if it were necessary.

48. Mr. JOKO-SMART (Sierra Leone) pointed out that the confidence which parties had in the arbitral tribunal did not necessarily extend to the experts appointed by that tribunal. The existing text of article 26 should be retained.

49. Mr. ABOUL-ENEIN (Observer for the Cairo Regional Centre for Commercial Arbitration) and Mr. KADI (Algeria) expressed a preference for the original text of article 26.

50. Mr. LEBEDEV (Union of Soviet Socialist Republics) agreed to withdraw his amendment but asked for the support it had received to be reflected in the report.

51. Mr. MATHANJUKI (Kenya) noted that the text of article 26 (1) (b) stated that a party might be required to provide information for the expert. It should be made clear that either or both parties might be required to provide such information.

52. The CHAIRMAN said that "a party" should be interpreted to mean "each party".

53. Mr. SEKHON (India), speaking on article 26 (2), proposed that the word "interrogate" should be replaced by "examine", to read "... the parties have the opportunity to examine [the expert]".

54. Mr. ENAYAT (Observer for the Islamic Republic of Iran) said that article 26 (2), which stated that "the parties have the opportunity to interrogate [the expert]", should make clear that such examination could not be done directly by the parties but only through the arbitral tribunal.

55. The CHAIRMAN said that, if there were no objection, he would take it that the Commission agreed to retain article 26 in its present form.

56. *It was so agreed.*

Article 27. Court assistance in taking evidence

Article 27 (1)

57. Mr. PELICHET (Observer for The Hague Conference on Private International Law) said that the phrase "in this State or under this Law" in the English version of article 27 (1)

was ambiguous; it should be brought into line with the French version, which read "in this State and under this Law". As stated in his organization's written comments (A/CN.9/263/Add.1, pp. 15-16, para. 1, under art. 27), a special commission of The Hague Conference had met to decide whether the scope of the Convention on the Taking of Evidence Abroad in Civil or Commercial Matters (The Hague, 1970) might be extended by the addition of a protocol to cover arbitral proceedings. The special commission had confirmed the technical feasibility of the scheme but had expressed doubts about its usefulness. He would welcome any comments on the matter.

58. The CHAIRMAN pointed out that the French version of article 27 had been corrected and brought into line with the English text (A/CN.9/246/Corr.1, French only).

59. Mr. SEKHON (India) pointed out that an arbitral tribunal could not usually make a direct request to a court for assistance. He proposed that the text of article 27 (1) should be amended so as to state that the arbitral tribunal "... may request, through a competent authority, ...".

60. In its present form, article 27 (1) could be understood to mean that a court would provide assistance only in the taking of evidence. He proposed that the introductory sentence of the paragraph should be amended to read "... the arbitral tribunal may request ... assistance in taking or securing evidence".

61. Mr. ROEHRICH (France) endorsed the proposal of the Observer for The Hague Conference that the first sentence of article 27 (1) should be amended to read "... held in this State and under this Law". The Model Law was designed to be adopted as national legislation and could not deal with the question of co-operation between courts of different countries. That question was still open and could perhaps be dealt with in the future. In view of the differing provisions of various legal systems, it seemed unwise to specify explicitly that only an arbitral tribunal or a party could request assistance in taking evidence. He therefore proposed that article 27 (1) should be worded more neutrally and should state that, with the authorization of the arbitral tribunal, a request for assistance could be submitted to a competent court. His delegation endorsed the written proposal of Austria (A/CN.9/263, p. 39, para. 4) that subparagraphs (a), (b) and (c) should be deleted as unnecessary.

62. Mr. STROHBACH (German Democratic Republic) expressed support for the territorial approach advocated by Japan, Austria and the Soviet Union in their written comments (A/CN.9/263, p. 38, paras. 2, 4 and 5). He agreed that subparagraphs (a), (b) and (c) of article 27 (1) should be deleted as unnecessary.

63. Mr. SAWADA (Japan) confirmed his Government's comments (A/CN.9/263, p. 38, para. 1) concerning the scope of article 27 and the need to delete the words "under this Law" in paragraph (1), as well as its support for the Working Group's decision that the article should deal only with court assistance to an arbitration taking place in the State of the court giving that assistance (A/CN.9/263, p. 39, para. 2). His Government was not against assistance in obtaining evidence, but considered that the taking of evidence beyond national borders would be better regulated by international conventions than by a provision in the Model Law, which was intended to become a domestic statute.

64. Mrs. RATIB (Egypt) said that her Government believed that the application of article 27 should be limited to arbitral

proceedings held in the State concerned. It would be excessive to oblige a State to lend assistance to arbitral proceedings held outside its own territory.

65. Mr. AYLING (United Kingdom) agreed with the French representative's remarks both on points of substance and on points of form, on the understanding that the proposals by that representative would not confer on the State in which the Model Law was to apply, discretion as to whether there should be court assistance or not; that discretion belonged to the tribunal or to the parties.

66. Mr. HOLTZMANN (United States of America) withdrew his Government's written amendment (A/CN.9/263, p. 39, para. 3), which would have empowered courts in the State in which the arbitration was held to transmit requests for assistance in obtaining evidence to courts in other States. It now felt that there was little practical need for such provisions in the Model Law or in a convention; besides, arbitration could be delayed for as much as six months or a year by requests for evidence to courts outside the country. He saw no need for a reference to the territorial scope in article 27 (1), since that would be covered elsewhere. He supported the Austrian written suggestion that subparagraphs (a), (b) and (c) should be deleted (A/CN.9/263, p. 39, para. 4).

67. He also supported Sweden's written suggestion (A/CN.9/263, p. 39, para. 6) for the inclusion of a provision that would empower the arbitral tribunal to order the party in possession of evidence to produce it and would specify that refusal to comply would be interpreted to that party's disadvantage. He suggested that the idea should be noted in the report as the Commission's view.

68. He supported the French amendment to the first part of article 27 (1), on the understanding that a request could be made only by the arbitral tribunal or by one of the parties.

69. Mr. SAMI (Iraq) supported the French amendment to replace the word "or" by "and" in the first line of article 27 (1). Regarding the authority receiving the request, he proposed that words on the following lines should be added to the paragraph: "The authority receiving the request shall be the court or the authority mentioned in article 6." He also supported the Austrian suggestion to delete subparagraphs (a), (b) and (c).

70. The CHAIRMAN said he had the impression that there was wide agreement that the article should apply only to arbitrations taking place in the territory of the State. He suggested that, pending discussion of a secretariat proposal on the subject, the reference to arbitral proceedings "held in this State" should be retained. There was also support for the deletion of subparagraphs (a), (b) and (c) in article 27 (1). Regarding the French amendment to that paragraph, he suggested that it might be unwise to amend a text which had been agreed upon as a compromise after prolonged discussion. He wished to know whether the members of the Commission were prepared to reach preliminary agreement on those lines.

71. Mr. SAMI (Iraq) suggested that article 27 should be added to those listed in article 6.

72. Mr. HERRMANN (International Trade Law Branch) explained that article 6 was concerned with centralizing the functions of a specially designated court. It would have been inappropriate for the list in it to include article 27, which was concerned with matters such as hearing witnesses, obtaining access to premises, and so forth; in these matters, local court

jurisdiction was determined by other factors, such as residence of witness or location of premises.

73. Mr. MATHANJUKI (Kenya) agreed with the Chairman's conclusions but thought that the Indian amendment to article 27 (1) should be borne in mind.

74. Mr. LAVINA (Philippines) also agreed with the Chairman's conclusions but considered that it might, on rare occasions, be necessary to request assistance from a court in a foreign State, as indicated in the United States proposal, now withdrawn. He supported the proposal to delete subparagraphs (a), (b) and (c) in article 27 (1).

75. Mr. TANG Houzhi (China) said that he entirely agreed with the Chairman's summing up. He also supported the French amendment to article 27 (1).

76. Mr. VOLKEN (Switzerland) said that he too supported the Chairman's conclusions.

77. In his opinion, the French amendment was not strong enough. The matter to be regulated was the contact between the arbitral tribunal and the State court. He suggested wording on the following lines: "When a court of this State receives a request for obtaining evidence from an arbitral tribunal, this State court shall act on such a request."

78. Mr. SEKHON (India) said that he agreed with the Chairman's summing up and supported the territorial approach in article 27 (1). He pointed out that the definition of "court" in article 2 would not be appropriate to article 27 as far as routing of requests was concerned, since more often than not requests were made by bodies which were not bodies or organs of the judicial system of a country.

79. The CHAIRMAN suggested that it should be noted in the report that the rules in question did not apply to routing of requests but only to originating and complying with requests.

80. *It was so agreed.*

81. Mr. KADI (Algeria) also endorsed the Chairman's summing up. Regarding the question raised by the representative of Iraq, he saw a link between articles 25 and 27, because both dealt with assistance. If the Iraqi proposal were supported, he would suggest a draft on the following lines: "In arbitral

proceedings held in this State and in accordance with article 6, the arbitral tribunal may request assistance from a competent court in taking evidence or obtaining documents."

82. The CHAIRMAN said that if there were no objections the amendment could be sent to the drafting committee.

83. *It was so agreed.*

84. Mr. LOEFMARCK (Sweden) drew attention to his Government's suggestion (A/CN.9/263, p. 39, para. 6) that an explicit provision should be included to the effect that refusal of a party possessing evidence to comply with an order to produce it should be interpreted to that party's disadvantage. If that notion were generally accepted, he would be satisfied if it was simply mentioned in the report.

85. The CHAIRMAN said that the report would mention the proposal and also that it had not been opposed.

86. *It was so agreed.*

87. Mr. LEBEDEV (Union of Soviet Socialist Republics) agreed with the Chairman's summing up but asked whether the scope of territorial application would be included in article 27 or in a separate article, as proposed by the secretariat (A/CN.9/XVIII/CRP.12).

88. The CHAIRMAN said that for the time being, territorial scope would be included in article 27 but might prove superfluous when the secretariat proposal came to be discussed.

Article 27 (2)

89. Mr. LAVINA (Philippines) proposed the deletion of the concluding portion of the paragraph "either by taking the evidence itself or by ordering that the evidence be provided directly to the arbitral tribunal". The provision would thus end at the word "request".

90. The CHAIRMAN said that in the absence of any opposition he would take it that the Commission agreed to adopt article 27 (2) with that amendment.

91. *It was so decided.*

The meeting rose at 12.25 p.m.

326th Meeting

Monday, 17 June 1985, at 2 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 2.10 p.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264)

Article 28. Rules applicable to substance of dispute

Article 28 (1)

1. Mr. BONELL (Italy) said that his delegation welcomed paragraph (1) because most existing national laws on arbitration did not deal with the law applicable to the substance of the dispute. That created difficulties with regard to disputes of an international character. So far, the problem had been

solved either by applying the law of the place of arbitration or the law of the procedure selected by the parties, or by leaving it to the arbitral tribunal to determine the rules of private international law it considered appropriate to the case. Both solutions were unsatisfactory; the first because frequently there was very little connection between the place of arbitration and the substance of the dispute, and the second because of the uncertainty to which it could give rise. In both cases it was assumed that, just like a national court, the arbitral tribunal should settle disputes according to the substantive law of a given State. His delegation, on the other hand, considered that parties should be allowed to denation-

alize the dispute by indicating as a basis for its settlement rules and principles of a different nature, taken, for example, from international instruments, whether in force or not, widely observed trade usages and principles or rules common to the national legal systems of both parties.

2. Mr. KIM (Observer for the Republic of Korea) proposed that the title of article 28 should be amended to read "Rules and principles applicable to substance of dispute". The first sentence of paragraph (1) should correspondingly be amended to read "The arbitral tribunal shall decide the dispute in accordance with such rules and principles of law as are designated by the parties". The remainder of the first sentence and the second sentence, which was redundant, should be deleted.

3. Mr. SZASZ (Hungary) said that paragraph (1) introduced a new approach to the choice of applicable law. His Government would have preferred a more traditional one, but if there was massive support for the paragraph, it would accept it. All the same, the term "rules of law" was very imprecise and would give rise to numerous difficulties of interpretation in national legislations. That seemed clear from the written comments on the article. He would recommend that any country adopting the term should provide a definition of it. He approved the second sentence of paragraph (1) for usefully making clear that the position was about conflict of laws rules.

4. The CHAIRMAN observed that without that sentence the parties might find that the legal system of their choice referred them unexpectedly to that of a third State.

5. Mr. HOELLERING (United States of America) approved the existing text of the first sentence and the idea of extending party autonomy to the step of designating the applicable law. The time was ripe for giving parties a new and wider range of options for the rules of law which might apply to the settlement of international commercial disputes. His delegation also approved the second sentence of the paragraph.

6. Mr. SEKHON (India) said he felt that the present text of paragraph (1) would create unnecessary confusion. He would prefer it to be replaced by the formulation used in article 33 (1) of the UNCITRAL Arbitration Rules.

7. Mr. BOGGIANO (Observer for Argentina) said that the text of paragraph (1) should be approved, on the understanding that the expression "rules of law" did not mean exclusively the national law of a given State; the parties would thus be able to subject their dispute to international rules and practices or international conventions as well. In view of the broad scope of application of the Model Law and the wide interpretation it gave to the word "commercial", a large number of relationships might become subject to arbitration. It was therefore appropriate to give parties the greatest possible autonomy, within the limits set by the Model Law in respect of public policy, for subjecting complex contractual and other relationships to rules of their choice.

8. Mr. SCHUMACHER (Federal Republic of Germany) said that in its written comments (A/CN.9/263, p. 40, para. 3) his delegation had already expressed its appreciation of the wide range of options offered to parties by paragraphs (1) and (3) of article 28. In its understanding, the term "rules of law" gave parties the possibility to choose as applicable a mixture of rules from more than one legal system. That followed from paragraph (3), for if parties were free to agree on a decision *ex aequo et bono* they must also be free to agree on the application of legal rules from wherever they were drawn. His delegation was in favour of paragraph (1) as it stood.

9. Mr. ROEHRICH (France) said that his delegation fully approved paragraph (1). The principle of party autonomy required that parties should be free to choose a mixture of different legal systems, or trade usages or international conventions which had not yet entered into force, as the rules of law appropriate for their purposes. He also approved the prohibition of unintentional referral which the second sentence of paragraph (1) provided.

10. Mr. GRAHAM (Observer for Canada) said that he was in favour of paragraph (1) as it stood.

11. Mr. LEBEDEV (Union of Soviet Socialist Republics) referred to his delegation's written comments on paragraph (1) (A/CN.9/263, p. 41, para. 5), in which it expressed its desire for a more traditional approach to a complex and controversial issue than the paragraph provided. Instead of using the very vague concept of "rules of law", the paragraph should refer to "law" as that term was understood in international conventions in force and in the UNCITRAL Rules and other similar international documents. That was the traditional approach; it had proved effective in practice and would be understood by those applying the Model Law. The expression "rules of law" was an innovation the use of which had not really been justified or well defined by its proponents. He agreed with them that parties should have an opportunity to select the laws not of one country but of several, a process which had begun with the introduction into French jurisprudence of the concept known as *dépeçage*. However, the use of the expression "rules of law" did not address that issue, which would have to be solved by national conflict of laws rules and international conventions dealing with them.

12. The proponents of change had also said that it was desirable to allow arbitrators to settle disputes on the basis of rules designated by the parties. That would be a matter of the terms of the contract between the parties, which could refer to model rules or model contracts in various fields of trade. The point had also been made that parties should be free to call for the application of trade usages. He thought it would be better to adopt *expressus verbis* the approach to those questions set out in article 33 (3) of the UNCITRAL Arbitration Rules, which required the arbitrators to apply the terms of the contract and take into account the usages of the trade. In that way the desiderata he had mentioned would be accommodated directly and not, as in the present text, indirectly by the use of the nebulous expression "rules of law".

13. Mr. KADI (Algeria) supported the changes proposed by the Soviet Union representative. He was in favour of the text of paragraph (1) in all other respects.

14. Mr. VOLKEN (Observer for Switzerland) said that he too did not care for the term "rules of law". The Soviet Union representative had drawn attention to the fact that its use seemed intended to permit the process known as *dépeçage*. The 1980 Rome Convention on the Law Applicable to Contractual Obligations had gone a step in that direction in that it permitted different parts of a contract to be subject to different law, but it did that as an exception, whereas the present text of paragraph (1) might suggest that *dépeçage* was the basis of the rule. With such a provision there was a danger of allowing the contract as a whole to be split up into too many parts. For that reason, his delegation would prefer a text on the lines of article 33 (1) of the UNCITRAL Arbitration Rules.

15. Mr. OLUKOLU (Nigeria) said that his delegation had difficulty in accepting paragraph (1). Like the representatives

of India and the Soviet Union, he would advocate the adoption of the UNCITRAL Rules on the subject.

16. Mr. DUCHEK (Austria) said that his approach was much the same as that of the Hungarian representative. His delegation could accept the present wording of paragraph (1) but it would not be disappointed if the paragraph mentioned the notion of "law" instead of "rules of law". He had nothing against permitting parties to combine laws from more than one national legal system, but in practice such an arrangement rarely appeared in contracts. As to international conventions, it was a matter of technique whether parties wrote the rules concerned into their contract or made a general reference by name to the relevant convention as, for example, the 1980 United Nations Convention on Contracts for the International Sale of Goods. Although he did not share the concerns expressed by the Soviet Union representative, he thought it was essential for the Commission's understanding of the paragraph to be clarified in the report. The reference in the secretariat commentary to "rules of law" as providing the parties with a "wider range of options" (A/CN.4/264, p. 61, para. 4) was far too vague to serve that purpose.

17. Mr. STROHBACH (German Democratic Republic) endorsed the views expressed by the Soviet Union representative. He too would like the paragraph to refer to the terms of the contract and trade usages and to employ the expression "law", well known in the context, instead of "rules of law". He therefore advocated the reformulation of paragraph (1) along the lines of the UNCITRAL Arbitration Rules.

18. Mr. GOH (Singapore) said that his delegation was happy with the existing draft, which gave recognition to widely accepted practices. In his understanding, the terms "rules of law" and "law" conveyed the same meaning, and any distinction drawn between them was largely a question of semantics.

19. Mr. MOELLER (Observer for Finland) said that his delegation would prefer the term "law" to "rules of law", since many of those in Finland who had been asked to comment on the draft had had difficulty in understanding the latter term. However, there was not much difference in substance or in practice between the two terms, and if many delegations were strongly in favour of the term "rules of law", his delegation could accept it.

20. Mr. SAWADA (Japan) said that "law" on the one hand and a decision *ex aequo et bono* on the other could be regarded as two poles between which lay something else, namely the rules of businessmen and business associations. He agreed with the view of the Federal Republic of Germany that the term "rules of law" should be interpreted in a broad sense to cover that intermediate position allowing deviation from provisions of law. Although the Soviet Union representative had indicated that the term was too nebulous, but the classical concept of "law" would be too narrow. Perhaps the Commission should add to the expression "rules of law" in paragraphs (1) and (2) the term "trade usages" to cover the position fully.

21. Mr. ENAYAT (Observer for the Islamic Republic of Iran) said that his delegation would like the wording of paragraphs 1 and 2 of article 33 of the UNCITRAL Rules to be used for paragraphs (1) and (2) of article 28 of the Model Law. It could accept the text proposed by the Working Group for article 28 (3).

22. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) said that her delegation would be reluctant to accept

the first sentence of article 28 (1) as it stood; the expression "rules of law" left the door wide open to extravagant choices by the parties, including the application of a combination of rules drawn from various legal systems and possibly also from an international legal instrument which might or might not have come into force. She favoured instead the use of article 33 (1) of the UNCITRAL Arbitration Rules, which employed the term "law". As to the second sentence, she could accept the wording proposed by the Working Group.

23. Mr. PELICHET (Observer for The Hague Conference on Private International Law) said that if the expression "rules of law" permitted *dépeçage* or dismemberment, it would be a shame to exclude that option by returning to the wording of the UNCITRAL Rules, since the current trend in private international law was to permit *dépeçage*. Also, if "rules of law" was understood as referring to laws not enacted by a State legislature, party autonomy would not be restricted. The main concern was that the parties should be entirely free to choose whatever rule they pleased for their contract.

24. Mr. PAULSSON (Observer for the Chartered Institute of Arbitrators) said that in practice a contract scarcely ever referred to several national bodies of law; however, parties often stipulated that a particular portion of a body of law did not apply to a contract. Swiss law, for example, was often viewed as being appropriately neutral for international contracts but as allowing too much scope for judicially ordered set-off. Consequently, parties often accepted Swiss law for settlement of their disputes with the exception of the provision which established judicially ordered set-off. If the term "law" was incorporated in the text, arbitrators might be tempted to conclude that the parties had made an inappropriate choice.

25. Mr. RAMOS (Observer for Portugal) said that he approved the text as it stood, including the reference to "rules of law", which expanded the range of choice available to the parties.

26. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that he fully approved the text as it stood. Contracts often incorporated a reference to a law as it was worded at a given time but stipulated that any subsequent amendments to it would not necessarily apply to the contract.

27. Mr. MTANGO (United Republic of Tanzania) suggested that the problem facing the Commission might be overcome if the text read "law and/or rules of law".

28. Mr. ROEHRICH (France) said that the important point was that the parties must have the right to choose for the settlement of their dispute a set of provisions which was not necessarily contained in an enacted law and would enable the arbitrators to decide the dispute as flexibly as possible. Above all, parties wished to be certain that it would be settled on the basis of known considerations, which might be trade usage, the provisions of a convention which had not yet entered into force or the legislation of a third country.

29. Mr. BONELL (Italy) said that, at present, parties who entered into an arbitral agreement had only two choices: to ask either that the decision be based on law or that it be made *ex aequo et bono*. Article 28 (1) was intended to show that there were other options: the application, for example, of the rules of law of any given country or of the provisions of a convention which had not yet entered into force. If the Commission reverted to the traditional term "law", it would miss a marvellous opportunity to assist parties in overcoming

the many difficulties that they encountered precisely because the current system offered them only two options.

30. Mr. SZASZ (Hungary) said that international commercial arbitration had evolved in such a way that parties were now able to choose the law of any State for application to their disputes. They were also free to supplement non-mandatory provisions of law in accordance with their declared or presumed will, and some States now permitted the situation that, if parties did not make an express choice, a decision need not be made *ex aequo et bono* and another type of procedure could be applied. The Model Law must allow parties to use, as the applicable law, the provisions of conventions which had not yet entered into force. Mentioning *dépeçage* in article 28 (1) would not leave them as free as did the term "rules of law", which was much broader. The traditional approach, that of using the word "law", would also enable parties to choose separate rules for certain obligations.

31. Mr. VOLKEN (Observer for Switzerland) said that a reference to *dépeçage*, which had been widely acknowledged to be an acceptable practice, should be included in the text of the article.

32. Mr. BONELL (Italy) said that his delegation could not accept that.

33. The CHAIRMAN said that although the Commission still seemed to be divided as to how to deal with paragraph (1), considerable support had been expressed for the idea that the reference to "rules of law" should be replaced by a reference to "law" and that the latter notion should be interpreted in a broader sense than previously in the light of developments in international commercial arbitration practice. It also seemed to be a widely held view that the paragraph should at least contemplate allowing the parties to engage in the process known as *dépeçage*; in other words, the specification of different rules as being applicable to different parts of the contract.

34. Accordingly, if he heard no objection, he would take it that the Commission wished to replace the words "rules of law" by the word "law" in the first sentence of paragraph (1); to refer the paragraph to the drafting committee with a view to the incorporation in it of wording which reflected the notion of *dépeçage*; and to explain in the report that the term "law" should be understood in a broader sense than previously.

35. *It was so agreed.*

36. Mr. TORNARITIS (Cyprus) said that the decision to use the word "law" instead of the words "rules of law" in paragraph (1) was consistent with paragraph (2), where the term "law" was also used. The difficulty that the Commission had experienced arose partly from the fact that the English language had only one word for the two notions expressed in French as "*droit*" and "*loi*". He saw paragraph (1) in terms of principles of law rather than rules of law. Thus, paragraph (1) would give the parties liberty to adopt any principles of law that they chose, and failing any designation by them, the law applicable would be that referred to in paragraph (2).

Article 28 (2)

37. Mr. BONELL (Italy) withdrew the amendment proposed by his delegation in its written comments (A/CN.9/263, p. 41, para. 7).

38. Mr. SAWADA (Japan) said that paragraph (2), in referring to conflict of laws rules, conformed to article 33 (1) of the UNCITRAL Arbitration Rules. However, he favoured removal of the reference to the conflict rules for two reasons: (1) it would be simpler directly to designate a substantive law; (2) the conflict rules would point only to the "narrow" law and that would not accord with the decision just taken to give a wide meaning to the term "law" in the first paragraph.

39. Mr. SCHUMACHER (Federal Republic of Germany) said that in its written comments his delegation had expressed reservations in regard to paragraph (2) but was now prepared to allow more discretion to the arbitrators than it had earlier thought desirable. It therefore withdrew its objection to the paragraph, which was in conformity with the 1961 European Convention, the ICC rules and the UNCITRAL Arbitration Rules.

40. Mr. HOELLERLING (United States of America) said that his delegation had reached the conclusion that the conflict of laws provision should be deleted in order to provide for a more flexible and modern approach to the international commercial arbitration process. In that connection, it agreed with the written comments of Sweden (A/CN.9/263, p. 40, para. 2) and ICC (A/CN.9/263/Add.1 (article 28), p. 16, para. 1).

41. His delegation strongly recommended that paragraph (3) or some other part of the article should contain a reference to the terms of the contract and to trade usages. That language had been deleted from the draft text by the Working Group on International Contract Practices at its sixth session (A/CN.9/245, para. 99). However, it was to be found in article 33 (3) of the UNCITRAL Rules and had been adopted and recommended by the General Assembly as being acceptable to countries with different legal systems. It was also to be found in article VII (1) of the 1961 European Convention.

42. Mr. STROHBACH (German Democratic Republic) said that paragraph (2) should remain as it was, as being in harmony with the 1961 European Convention.

43. Mr. BOGGIANO (Observer for Argentina) said that he was in favour of deleting the reference to the conflict of laws rules. Its removal would allow a wider interpretation of the word "law", which would then be consistent with its use in paragraph (1). His delegation would agree to the deletion on the understanding that the arbitrators could apply a conflict of laws rule if they deemed it necessary but could also use more direct means to find the appropriate law.

44. Mr. ROEHRICH (France) said that one reason for deleting the reference to conflict of laws rules was that it was counter to the modern trend in international commercial arbitration practice.

45. Mrs. RATIB (Egypt) said that her delegation was in favour of paragraph (2) as it stood. A point to bear in mind was that under article I (2) (c) the parties to a dispute could expressly agree that the subject-matter of the arbitration agreement related to more than one country; in other words, two nationals of the same country could agree that the subject-matter of the arbitration was of an international character. The arbitration process would then take place in the territory of the two nationals but the arbitrators would be free to decide to apply the law of a different territory. She doubted whether that was advisable.

46. Mr. LOEFMARCK (Sweden) said that in its written comments on the article as a whole (A/CN.9/263, p. 40,

para. 2), his delegation had suggested that the article as it stood reflected a rather traditional view of the question and that if it was adopted, there might be a risk of impeding the trend towards a freer judgement of the question of choice of law. His delegation was therefore in favour of deleting the reference in paragraph (2) to conflict of laws rules.

47. Mr. SZASZ (Hungary) said that his delegation was in favour of leaving the text as it stood because it was concerned about the relationship between paragraphs (1) and (2). If the term "law" was going to be taken as encompassing things that were not actually law, it would be difficult to be sure of the meaning of paragraph (2) and would lead to giving it equal status with paragraph (1) as far as the question of law was concerned. However, his delegation would not object strongly to the proposed deletion because there was certainly a trend in international trade law of the kind described by the Swedish representative.

48. Mr. GRIFFITH (Australia) said that his delegation was in favour of deleting the reference to conflict of laws rules. It considered the relationship between paragraphs (1) and (2) to be sufficiently well established.

49. Mr. BONELL (Italy) said that his delegation also supported the Japanese proposal. The term "law" as used in paragraph (1) was to be explained in the report. As far as its use in paragraph (2) was concerned, it should be understood that national legislatures should adopt a consistent approach to the two paragraphs when transferring the Model Law to their own legislation.

50. Mr. SAMI (Iraq) said that the deletion of the reference to the rules of conflict of laws would make paragraph (2) consistent with paragraph (1).

51. Mr. TANG Houzhi (China) said that he was in favour of leaving both paragraphs as they stood. His delegation opposed the suggestion to delete the reference to conflict of laws rules from paragraph (2) because it believed that without it the arbitral tribunal would be likely in most cases to apply the law of the place of arbitration. Furthermore, the UNCITRAL Rules used that wording.

52. Mr. MATHANJUKI (Kenya) said that his delegation too felt some apprehension about the deletion, since it would give too much power to the arbitral tribunal, particularly when two parties coming from two different legal systems were involved in the dispute. The arbitral tribunal ought to have to take into account the law most closely connected with the performance of the contract.

53. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that paragraph (2) should be left as it stood. It represented a well-known compromise that had been achieved in 1961 during the preparation of the European Convention. The aim of the compromise was to establish certainty and predictability in the arbitrators' choice of the applicable law. They would be required to choose one system at the outset of the conflict, on the basis of which they would determine the applicable law. The deletion of the reference to conflict of laws rules would grant the arbitrators absolute freedom in the choice of the applicable law and would constitute a precedent that would be unacceptable to many countries. His delegation considered, therefore, that acceptance of the text proposed by the Working Group was the best course.

54. Mr. GRAHAM (Observer for Canada) said that he favoured the idea of deleting the reference to conflict of laws rules, for the reasons expressed by previous speakers.

55. Mr. DUCHEK (Austria) said it was true that, in matters of international commercial arbitration, predictability was an important criterion. He was not certain, however, that it would be satisfied any more easily with the existing text than with the wording which would result from the deletion. Conflict of laws rules were themselves very flexible and could well allow resort to the law most closely connected with the subject of the dispute. As it stood, the paragraph could create a situation in which the parties might well be surprised by the ultimate ruling as to which law would apply. If they had foreseen such a possibility, they might have come closer to agreeing between themselves on the choice of law. It was important, therefore, for the arbitrators to inform the parties as soon as possible what set of rules their decision would be based on.

56. His delegation therefore considered that, while keeping the reference to conflict of laws rules would not greatly affect the situation, its deletion would make the relationship between paragraph (2) and paragraph (1) awkward. The word "law" used in paragraph (1) could, in the interest of party autonomy, be interpreted as including conventions not yet in force. The situation in paragraph (2) was different, in that "law" would mean existing national law. It might therefore be advisable for the Commission to reconsider its decision to replace the words "rules of law" in paragraph (1) by the word "law" if its intention was to restrict paragraph (2) to law in the sense of a national set of rules. If that was done, his delegation would be able to agree to the deletion of the reference to conflict of laws rules.

The meeting rose at 5.05 p.m.

327th Meeting

Monday, 17 June 1985, at 7 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 7.05 p.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264)

Article 28. Rules applicable to substance of dispute (continued)

1. Mr. KIM (Observer for the Republic of Korea) saw no need to include the phrase "conflict of laws" but proposed, as a compromise, to insert after the words "conflict of laws rules" the additional wording "and/or the general rules and

principles of private international law". He further proposed an additional clause to the effect that in cases where the parties agreed, or the tribunal deemed it necessary, the tribunal could apply any established custom or usage of international trade.

2. The CHAIRMAN said that that proposal would involve the reconsideration of article 28 (1) since it would give wider powers to the arbitrators than to the parties, thereby reversing the present position.

3. Mr. TANG Houzhi (China) suggested that the deletion of the words "conflict of laws" might lead to a situation where courts in developing countries were excluded. Where the parties designated in their agreement a third country as the place of arbitration but failed to state which law applied, then it was likely that the law of that third country would apply, because it would be considered that such was the intention of the parties. However, if the reference to conflict of laws rules was retained, the arbitral tribunal would use those rules in determining which law to apply, and where one of the parties was from a developing country, the law of that country might thus be considered as the applicable law. That possibility of applying the law of a developing country should not be excluded.

4. He felt that consistency between paragraphs (1) and (2) was not the most important consideration. To avoid discrepancy, it would in any case be better to retain the text as drafted by the Working Group.

5. Mr. SEKHON (India) said that he preferred article 28 (1) to be formulated as in article 33 of the UNCITRAL Arbitration Rules. His delegation also now felt that article 28 (2) should be retained as it stood, since deletion of the reference to "conflict of laws" would give the arbitral tribunal too wide a discretion. It would be prudent to retain some degree of regulation.

6. Mr. VOLKEN (Observer for Switzerland) favoured deleting the words "conflict of laws" because they contributed little to the powers of the tribunal. In any event, an arbitral tribunal would have to justify its choice of applicable law. Under article 28 (2) as drafted, it would in addition have to justify its choice of conflict of laws rules, so that two justifications would be required. He also feared that the choice of conflict of laws rules, and the justification of that choice, would be influenced by the result desired. Deletion of the reference to conflict of laws did not exclude choice by the arbitrators and was therefore the better solution.

7. Mr. MTANGO (United Republic of Tanzania) thought that article 28 (2) should be retained as it stood.

8. Mr. BONELL (Italy) recalled that the Commission, despite divided opinion, had accepted change (the replacement of "rules of law" by "law") in paragraph (1); to be consistent, it should now accept the proposed change in paragraph (2), namely the deletion of "conflict of laws", on which opinion was also divided. Since that would be unsatisfactory, he proposed, as a compromise, that the decision relating to paragraph (1) should be reversed and that both paragraphs (1) and (2) should be retained as drafted.

9. The CHAIRMAN said that paragraph (1) had already been decided. The difficulty in the case of paragraph (2) was that without the reference to conflict of laws, it would no longer be in harmony with paragraph (1). Moreover, opinions on that point were equally divided.

10. Mr. JOKO-SMART (Sierra Leone) suggested that paragraphs (1) and (2) should be taken together. Once the parties had chosen the law to be applied, that law would include both substantive law and conflict of laws rules. There would therefore be no need to attempt to distinguish them.

11. Mr. MOELLER (Observer for Finland) said it was clear that the arbitrators must use some rules to determine the applicable law, and he supported the proposal by the representative of Italy.

12. Mr. RUZICKA (Czechoslovakia) said his delegation supported the text as it stood. With reference to the comments by the Observer for Switzerland, he stressed that the arbitral tribunal should pay main attention to the contract and should therefore deal with the conflict of laws rules first.

13. Mr. KADI (Algeria) favoured the retention of article 28 (2) as it stood.

14. Mr. MOURA RAMOS (Observer for Portugal) favoured keeping article 28 (2) as drafted. With regard to the problem raised by the Observer for Switzerland, he felt that, once the choice of conflict of laws rules had been justified, no further justification would be required. Moreover, if the phrase "conflict of laws" were deleted, it would allow the arbitrators to choose any substantive law they wished, and that would give them far too great a latitude.

15. Mr. LAVINA (Philippines) favoured retaining paragraph (2) as it stood for the reasons given by several representatives, including those of the Soviet Union, China and Japan. He also felt that consistency between paragraphs (1) and (2) was required and that it would therefore be better to retain the words "rules of law" in paragraph (1). As a matter of procedure, where there was equally divided opinion, the draft as prepared by the Working Group should be retained.

16. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that article 28 was in effect no more than a guideline, since there were no sanctions in the Model Law for failure to observe its provisions. There was, for example, no possibility of setting aside the arbitral decision under article 34 if the arbitrators did not apply the applicable law. A guideline might be useful if its content had been agreed, but the fact was that the Commission could not agree on what was to be included in the article and it might therefore be better to take a more radical approach and delete both paragraphs altogether.

17. Mr. ROEHRICH (France) said that a law on international commercial arbitration could not remain silent on the choice of law governing the arbitration. He agreed with the comments of the representative of the Philippines. Lastly, with regard to the choice of rules for arbitration, it was reasonable that the parties should have greater freedom than the arbitral tribunal.

18. Mr. LOEFMARCK (Sweden) said that he agreed with the representative of the Soviet Union and felt that at least the first sentence of paragraph (1) and of paragraph (2) should be deleted. His delegation could, however, also accept the text of the two paragraphs as drafted by the Working Group.

19. Mr. GRIFFITH (Australia) said that, looking at article 28 as a whole, it would be better for the Commission to retain the text as drafted by the Working Group. Where there was not clear support for a change, it was appropriate to retain the text drafted by the Working Group.

20. Mr. MTANGO (United Republic of Tanzania) proposed the inclusion of both the alternative wordings for paragraph (1), leaving it to individual States to select whichever they felt appropriate. It would then be possible to retain paragraph (2) as it stood.

21. Mr. HOELLER (United States of America) opposed the deletion of paragraphs (1) and (2). The two paragraphs were interrelated and had been discussed at length in the Working Group, which had reached a consensus on the

drafting of the text. A reasonable solution, therefore, would be to accept the text as it stood. He did not favour leaving options open, as the role of the Commission was to give guidelines.

22. Mr. JOKO-SMART (Sierra Leone) agreed with the representatives of the United States and France that article 28 could not be omitted from the Model Law. He could accept the text as it stood.

23. Mr. HOELLERLING (United States of America) proposed the insertion of a new paragraph (3) to provide that the arbitral tribunal should decide in accordance with the terms of the contract and take account of the usages of the trade applicable to the transaction, in line with article 33 (3) of the UNCITRAL Arbitration Rules.

24. Mrs. VILUS (Yugoslavia) supported the United States proposal, although with reservations regarding the inclusion of the reference to terms of contract and the use of the wording "take into account".

25. Mr. BONELL (Italy) withdrew the Italian written proposal for an addition to the present article 28 (3) (A/CN.9/263, p. 42, para. 11).

26. Mr. BROCHES (International Council for Commercial Arbitration) suggested that the terms *amiable compositeur* and *ex aequo et bono* should be described as equivalents (for instance by using *amiable compositeur* in the French text, followed by *ex aequo et bono* in brackets, and dealing similarly with the English text) to avoid their being possibly interpreted as involving different procedures.

27. The CHAIRMAN thought that was a drafting point. He hoped that the proposal to include a new paragraph (3) relating to usages would adopt the wording of article 33 (3) of the UNCITRAL Arbitration Rules, in order to avoid a lengthy drafting discussion.

28. Mr. MTANGO (United Republic of Tanzania) supported the suggestion that the proposed new article 28 (3) should conform to article 33 (3) of the UNCITRAL Arbitration Rules.

29. Mr. AYLING (United Kingdom) said it was essential to introduce the rule proposed by the United States representative, which was similar to the one in the UNCITRAL Arbitration Rules, since the pre-eminent obligation of the arbitral tribunal was to determine the matter in dispute by applying the terms of the contract. His delegation therefore strongly supported the United States proposal.

30. Mr. PELICHET (Observer for The Hague Conference on Private International Law) said there was a contradiction between article 28 and article 2 (c), which permitted parties, when allowed to do so by "this Law", to decide on such matters as giving decision-making authority to a third party or institution. First, it was certainly not the intention of the Working Group to allow a body such as the International Chamber of Commerce to decide on which law to apply to a substantive dispute. Secondly, even if the parties allowed the arbitrators to do so, that would conflict with the provisions of article 28, whereunder the arbitral tribunal was bound to decide the dispute in accordance with the law chosen by the parties. If the two provisions remained as they stood, the arbitrators would not know whether they had freedom of choice or were bound instead by article 28. His organization had therefore proposed the inclusion in article 2 (c) of a reservation concerning article 28 (A/CN.9/263/Add.1, p. 5, para. 2 *in fine*).

31. Mr. VOLKEN (Observer for Switzerland) said he agreed with the Observer for The Hague Conference. Article 2 (c) was intended to deal with technical aspects and not with choice of the applicable substantive law.

32. Mr. BOGGIANO (Observer for Argentina) supported the view expressed by the Observer for The Hague Conference.

33. Mr. AYLING (United Kingdom) said that he could not accept the proposition that a dispute concerning the applicable law was not capable of being determined by an arbitral tribunal, since it was no different from any other dispute.

34. Mr. ROEHRICH (France) said that the provisions of article 2 (c) related only to the functional matters involved in the constitution of an arbitral tribunal. They did not extend to the substantive matters referred to in article 28 (2).

35. Mr. MATHANJUKI (Kenya) was opposed, at that late stage, to reopening discussion of the definitions contained in article 2 (c).

36. Mr. STROHBACH (German Democratic Republic) said that a solution would be to state in article 2 (c) where, in the Model Law, the parties were free to decide certain issues.

37. The CHAIRMAN suggested that that was a drafting problem and invited the Observer for The Hague Conference and the representative of the German Democratic Republic to submit a draft for consideration by the Commission.

38. With regard to article 28 as a whole, the feeling of the Commission appeared to be that paragraph (1), contrary to the earlier ruling, should be retained as drafted by the Working Group, that paragraph (2) should remain as drafted by the Working Group, that a new paragraph (3), corresponding to article 33 (3) of the UNCITRAL Arbitration Rules, should be inserted and that the former paragraph (3) should be renumbered paragraph (4).

39. *It was so agreed.*

Article 29. Decision-making by panel of arbitrators

40. Mr. GRIFFITH (Australia) said that he assumed that the reference to "a presiding arbitrator" in article 29 implied that the presiding arbitrator would be the third arbitrator chosen by the arbitrators appointed by the parties. As he understood it, it was also implicit in the Model Law that, in the absence of any express requirement to the contrary, it was not necessary for arbitrators to be formally present in order to take decisions. Decisions could be taken by telephone, telex or similar means of communication; that point should be recorded in the commentary on the Model Law for the guidance of national legislators.

41. Difficulties were bound to arise if, as stated in the second sentence of article 29, the arbitral tribunal were empowered to authorize a presiding arbitrator to settle procedural questions. In common law countries at least, the distinction between procedural and substantive matters was not always clear. That was not important where it was the parties that authorized a presiding arbitrator to take decisions and not the arbitral tribunal. In order also to avoid possible conflict between the arbitrators on such questions, he proposed the deletion of the words "or the arbitral tribunal".

42. The CHAIRMAN said the Commission might perhaps agree that it would be sufficient to mention in the report the matters referred to by the representative of Australia.

43. Mr. SEKHON (India) said he was concerned that, unlike in article 7 of the UNCITRAL Arbitration Rules, the Model Law contained no definition of the presiding arbitrator, nor did it indicate the manner of his appointment.

44. Mr. HERRMANN (International Trade Law Branch) said that the question of definition and appointment of the presiding arbitrator was encapsulated in the very careful wording of the second sentence of article 29. In English, the use of the indefinite article "a" before the words "presiding arbitrator" meant that there need not necessarily be such an appointment. With regard to the distinction between procedural and substantive matters, it had been felt, when drafting the article, that since the arbitral tribunal had powers to decide on matters both of procedure and of substance, it should also have power to decide on the distinction between them.

45. Mr. GRIFFITH (Australia) said that a presiding arbitrator authorized by the arbitral tribunal might not necessarily be the third arbitrator appointed by the arbitrators of the parties. In such a case, questions of procedure might be decided by an arbitrator designated by one of the parties alone. That would remove proceedings from the control of the parties, which was contrary to the intentions of the Model Law. His delegation would therefore prefer that the words "or the arbitral tribunal" should be deleted, but if that did not prove acceptable, it would prefer to retain the text as it stood.

46. Mr. MELIS (Austria) said he felt it was already implied in the first sentence of article 29 that the arbitral tribunal was empowered to authorize one of its members to take decisions. The reference to "the parties" in the second sentence should be deleted, since it was inconsistent. A problem could arise where two arbitrators authorized a presiding arbitrator to take decisions but that arbitrator refused to act alone. That problem could be avoided if a unanimous decision of the arbitral tribunal were required for the authorization of a presiding arbitrator.

47. Mr. MOELLER (Observer for Finland) said that where the arbitral tribunal could not reach a majority decision, the presiding arbitrator should decide as if he were sole arbitrator. It was essential, to avoid the wasting of time and money by the parties, that the arbitral tribunal should always reach a decision. With regard to the second sentence, he supported the proposal of the representative of Austria.

48. Mr. HOLTZMANN (United States of America) said that his delegation favoured the requirement of a majority decision. Where a presiding arbitrator was empowered to decide in the absence of a majority, he was in effect a sole arbitrator. If that was what parties wished, it would be cheaper and more practicable to appoint a sole arbitrator in the first place. In addition, the requirement of a majority decision made it more likely that all issues would be fully considered as a result of the need to reach agreement. Moreover, the parties would more readily accept the decision, thus reducing the likelihood of subsequent litigation or appeals. He therefore favoured the retention of article 29 as drafted.

49. Mr. LOEFMARCK (Sweden) said that he agreed with the representative of Finland that where there was no

majority, the presiding arbitrator should decide. The parties wanted a decision, and that a decision should be reached was more important than the manner of reaching it.

50. Mr. MELIS (Austria) agreed with the United States representative that where the parties had appointed three or more arbitrators, all should contribute to the decisions. However, in the entire history of the ICC, whose rules allowed a presiding arbitrator to take decisions where there was no majority, he knew of only two instances when that had in fact occurred. In practice, therefore, he foresaw little difficulty in the matter. Also, there was nothing in the first sentence of article 29 to prevent the parties, where the arbitral tribunal was unable to reach a decision, from authorizing a presiding arbitrator to decide alone. The first sentence of article 29 should therefore be retained as drafted.

51. Mr. ROEHRICH (France) agreed with the United States representative that, for the reasons stated by him, article 29 should be retained as drafted.

52. Mr. AYLING (United Kingdom) said that his delegation agreed that article 29 should be retained.

53. Mr. HOLTZMANN (United States of America) opposed the Australian proposal to delete the words "or the arbitral tribunal". To do so would make it inconsistent with the UNCITRAL Arbitration Rules and thus create a serious risk of conflict where the parties had agreed to use those rules.

54. Mr. TANG Houzhi (China) said he would like to delete the second sentence of article 29 altogether. Failing that, he preferred the Austrian proposal to insert the word "unanimously" at an appropriate place in that sentence.

55. Mr. MELIS (Austria) said that the real problem with the second sentence arose from the use of the word "however", which implied an alternative power to that given in the first sentence. That word should therefore be deleted.

56. Mr. SZASZ (Hungary) said that the Working Group had drafted the article in that form in order to clarify expressly the rights and powers of the parties and of the arbitral tribunal.

57. The CHAIRMAN proposed that the second sentence of article 29 should become a separate paragraph and that the word "however" should be deleted. It would also be specified that the arbitral tribunal's decision to authorize a presiding arbitrator to decide questions of procedure would have to be taken unanimously.

58. Mr. GRIFFITH (Australia) said that he favoured the retention of article 29 as drafted, subject to the amendments thus proposed.

59. The CHAIRMAN said that, in the absence of any objection, he would take it that the Commission agreed to approve article 29 as drafted, subject to the proposed amendments.

60. *It was so agreed.*

The meeting rose at 9.20 p.m.

328th Meeting

Tuesday, 18 June 1985, at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

The discussion covered in the summary record began at 11.10 a.m.

International commercial arbitration (continued)

(A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264)

Article 30. Settlement

Article 30 (1)

1. Mr. SEKHON (India) suggested that the last part of the paragraph should be reworded to read "record the settlement and make the award on the agreed terms".

2. The CHAIRMAN suggested that the amendment should be sent to the drafting committee.

3. *It was so agreed.*

4. Mr. GRIFFITH (Australia) said that his delegation considered that if the parties settled their dispute, they should be entitled to obtain a record of the settlement in the form of an arbitral award. There was no reason why the arbitral tribunal should have discretion not to make an award in those circumstances. He therefore proposed that the words "and not objected to by the arbitral tribunal" should be deleted.

5. Mr. GRAHAM (Observer for Canada) said that his delegation considered that it should be sufficient if the award was requested by one party. He therefore suggested that the words "requested by the parties" should be replaced by the words "requested by one of the parties".

6. Mr. HOELLERING (United States of America) said that the arbitral tribunal should have discretion not to approve a settlement, since an arbitral award recording agreed terms might include something they considered inappropriate.

7. Mr. MOELLER (Observer for Finland) said that he was in favour of the arbitral tribunal having the discretionary power, for the reasons stated in paragraph 2 of the secretariat's commentary (A/CN.9/264, p. 65) and emphasized by the United States representative. He would prefer the paragraph to remain unchanged.

8. Mr. SAMI (Iraq) supported the Australian proposal. If the two parties reached agreement, the proceedings should be terminated in a form appropriate to them if they so requested.

9. Mr. GRAHAM (Observer for Canada) opposed the proposal, for the reasons set forth in paragraph 2 of the secretariat's commentary. There were antitrust and other considerations which the arbitral tribunal should be able to take account of, regardless of any agreement by the parties.

10. Mr. de HOYOS GUTIERREZ (Cuba) said that the arbitral tribunal should not be able to object to a settlement being recorded in the form of an award. In the event of one of the parties failing to fulfil the agreement, the award would constitute useful evidence if the other party sought to enforce the settlement.

11. Mr. ROEHRICH (France) supported the Australian proposal and considered it reasonable. Arbitration was only a

manifestation of private justice, and an arbitral tribunal should not therefore have powers which conflicted with the will of the parties.

12. Mr. BARRERA GRAF (Mexico) also supported the Australian proposal.

13. Mr. HOELLERING (United States of America) said that his delegation felt very strongly that arbitrators should not be forced to concur in a settlement which might, for example, violate antitrust laws or income tax laws or be in furtherance of a conspiracy between the parties. The wording should remain unchanged; otherwise the arbitrators might simply be forced to resign from the case. There were also the UNCITRAL Arbitration Rules to consider.

14. In reply to a question from the CHAIRMAN as to what would happen if the arbitrators refused the parties' request, Mr. HOELLERING (United States of America) said that instances had been rare in which an arbitrator had not signed the award and the parties had been forced to rely on a private settlement agreement instead.

15. Mr. SZASZ (Hungary) said that a distinction must be made between the duty to terminate the proceedings and the duty to sign an award. It was true that if the parties reached agreement the arbitration proceedings could not continue. But the arbitrators should still be free to say that they did not agree with a settlement because it was against the law. If, therefore, the text was amended as suggested, it must make a distinction between the question of termination and the question of the award.

16. Mr. STROHBACH (German Democratic Republic) said that he entirely agreed with the preceding speaker.

17. Mr. GRIFFITH (Australia) withdrew his amendment in the light of the objections raised to it by other speakers, in particular the United States and Hungarian representatives.

18. The CHAIRMAN suggested that it should be noted in the report that the question of making an award should be left to the discretion of the arbitrators.

19. Mr. BONELL (Italy) agreed with the Chairman's suggestion. Regarding the Canadian proposal, he felt that if the text was amended to refer to a request by only one of the parties, it could easily be understood as implying that no further agreement was needed to transform the contractual agreement into an award. That would be unacceptable. He was strongly in favour of maintaining the existing text.

20. The CHAIRMAN suggested that since there seemed to be no strong feeling in favour of amending paragraph (1), it should remain as it was and be sent to the drafting committee in regard to the change suggested by the representative of India.

21. *It was so agreed.*

Article 30 (2)

22. Mr. SEKHON (India) said that if his amendment to paragraph (1) was accepted, the words "and shall state that it is an award" in paragraph (2) would be redundant.

23. The CHAIRMAN suggested that the matter should be referred to the drafting committee.

24. *It was so agreed.*

*Article 31. Form and contents of award**Article 31 (1)*

25. Mr. LAVINA (Philippines) said that the words "provided that the reason for any omitted signature is stated" should be deleted. In his view, whether the reason for an omitted signature was stated or not, the signatures of the majority of the members of the arbitral tribunal should be sufficient to validate the award. He asked what the position would be if the reason for an omitted signature was not given.

26. The CHAIRMAN said that paragraph (1) represented a compromise between two extreme positions: on the one hand, that the majority of the arbitrators could take any decision they wished; on the other, that all the arbitrators must sign an award. The latter position could lead to difficulties in the event of an arbitrator's death, illness, prolonged absence or refusal to sign. If the reason for an omitted signature was not given, the users of the arbitral award should request the reason from the arbitrators. He noted that a similar provision to paragraph (1) was found in article 32 (4) of the UNCITRAL Arbitration Rules. He suggested that the Commission should retain the existing wording.

27. *It was so agreed.*

Article 31 (2)

28. The Commission did not comment on paragraph (2).

Article 31 (3)

29. Mr. GRIFFITH (Australia) proposed that the provision in the second sentence should apply to the date as well as the place of the award.

30. Mr. BONELL (Italy) said that the application of the second sentence might create a legal fiction, since the place where the award was deemed to have been made might not necessarily be the same as the actual place of arbitration.

31. Mr. GRIFFITH (Australia) said that a similar legal fiction might arise with regard to the date of the award.

32. Mr. SZASZ (Hungary) said that there was an important difference between the date of the award and the place of arbitration. It was right, for reasons of the enforcement of the award, that the provision in the second sentence of paragraph (3) should apply to the place of the award. However, in the case of the date of the award, the parties should have the right to argue that the date on the award was not the true date.

33. Mr. HOLTZMANN (United States of America) said that he was inclined to favour the Australian proposal, which filled a gap. An arbitral award was often circulated by mail

among the arbitrators for signature, and the date on the award could be a deemed date just as the place of the award might be a deemed place. There were legal implications with regard, for example, to the payment of interest from the date of an award.

34. Mr. ROEHRICH (France) said that he could not really understand the Australian proposal. While there could be two places concerned, namely the place of arbitration and the place of the award, there could be only one date, namely the date on which the proceedings ended.

35. The CHAIRMAN pointed out that there could be several possible dates relating to the award: the date of signing it, the date of making it or the date of its notification to the parties. The aim of the Australian proposal was to prevent any litigation concerning the date of the award, but the Commission might not see any reason to forbid such litigation.

36. Mr. ROEHRICH (France) said that there could be litigation concerning the date, even with the existing text. The main thing was that the arbitrators should fix the date of the award; in that respect, the present text was satisfactory. The introduction of the notion of a deemed date might be more likely to lead to litigation than leaving the sentence as it was.

37. Mr. MOELLER (Observer for Finland) said that the purpose of the second sentence was to specify an irrebuttable presumption about the place of arbitration. The date of the award should not be treated in the same way. He did not favour the Australian proposal but thought that the drafting committee might find a way of overcoming the problem it addressed.

38. Mr. VOLKEN (Observer for Switzerland) said that the present text should be retained. He noted that a deemed date might have implications for the application of article 34 (3) concerning the time-limit for the setting aside of an award.

39. Mr. BONELL (Italy) said that arbitration rules or arbitration agreements often set a time-limit for the making of the award. It sometimes happened that the arbitrators were not able to keep within the time-limit. If the date of the award could not be rebutted, difficulties might arise, for example in connection with the discovery of new evidence.

40. Mr. HOLTZMANN (United States of America) said that the discussion had made it clear that the place of the award should be an irrebuttable presumption, while the date of the award should be a rebuttable one.

41. Mr. GRAHAM (Observer for Canada) said that the arbitrators could sit in one jurisdiction and make the award in another. The purpose of the provision was to give the arbitral tribunal flexibility in stating the place of the award.

42. Mr. JOKO-SMART (Sierra Leone) suggested that the Commission might dispose of the issue by redrafting the paragraph as follows: "The award shall state its date, the place where it is made and the place of arbitration as determined in article 20 (1)."

43. The CHAIRMAN said that he thought the suggestion made by the representative of Sierra Leone would lead to a very long discussion. Since there seemed to be little support for the Australian proposal, he would take it that the Commission wished to leave the paragraph unchanged.

44. *It was so agreed.*

Article 31 (4)

45. Mr. de HOYOS GUTIERREZ (Cuba) suggested that the paragraph should provide for the date of notification of the award, because any time-limit with respect to enforcement would run from that date. The date of notification could be determined by the criterion either of the date of dispatch or of the date of receipt.

46. The CHAIRMAN said that he did not see how the date of notification could be known in advance and indicated in the award. Proof of the date of dispatch or receipt could be obtained only after the event. He suggested that the Commission's report should refer to the point made by the representative of Cuba, indicating the importance of the date of notification and the need for proof of it to be provided where possible.

47. Mr. RUZICKA (Czechoslovakia) said that the status and effects of an award made under the Model Law could usefully be included in the article under discussion. His Government had proposed in its written comments (A/CN.9/263, p. 44) that a new paragraph should be added to the effect that an arbitral award made in accordance with the article had the force of *res judicata* and would be enforceable in the courts.

48. Mr. MOELLER (Observer for Finland) supported the Czechoslovak proposal because it emphasized the fact that an award did not need to be filed, registered or deposited with a court in order to be recognized or enforced.

49. Mr. ENAYAT (Observer for the Islamic Republic of Iran) said that the text should not be changed. The Czechoslovak amendment would not be consistent with the provisions concerning suspension of the setting-aside proceedings in article 34 (4).

50. Mr. ROEHRICH (France) said that the Czechoslovak proposal would duplicate the provisions of article 35 (1), which stated that an arbitral award should be recognized as binding irrespective of the country in which it was made.

51. Mr. HOLTZMANN (United States of America) pointed out that, under some legal systems, the concept of *res judicata* might be too limited for the purposes of the article under discussion.

52. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that it was important that the Model Law should specify whether the arbitration award became binding on the date it was made, the date on which it was notified to the parties or

at the end of the three-month setting-aside period mentioned in article 34 (3). The point was relevant to the recognition and enforcement of foreign arbitral awards under the 1958 New York Convention. The date on which an arbitral award became binding could be indicated in a separate paragraph or simply in a separate sentence.

53. Mr. BONELL (Italy) agreed with the Soviet Union representative that the date on which an award became binding should be indicated in the Model Law. He would prefer that to be done in article 31 (3) or article 31 (4). His delegation considered that the arbitral award should be binding from the date on which it was made. However, the Czechoslovak proposal was not an acceptable way of dealing with the matter because of its reference to *res judicata*.

54. The CHAIRMAN said that, in his personal opinion, the arbitral award should be binding from the date of its notification to the parties. If that view was acceptable, a statement might be added to article 31 (4) to the effect that the award was binding upon the parties from the date of its delivery to each party. If the award became binding from the day it was made, it would be binding on the parties before they had had a chance to study it. On the other hand, three months was too long a period to allow it not to be binding if there was clearly no prospect of either party seeking to set it aside.

55. Mr. HOLTZMANN (United States of America) said that his delegation supported the Soviet Union suggestion in principle but felt that the Commission had not yet had time to consider its implications. The Chairman's suggestion could mean that the arbitral award would become binding on each party on a different date.

56. The CHAIRMAN said that, in that case, the later of the two dates should be taken as the date on which the award became binding.

57. Mr. VOLKEN (Observer for Switzerland) asked why the matter had not been made clear in the original draft text of the Model Law.

58. Mr. HERRMANN (International Trade Law Branch) said that the issue had been raised in connection with article 35 but had not been dealt with in the text. It seemed best for an award to become binding on the date on which it was made, but as a safeguard, article 34 (3) stated that an application for setting aside could be made for three months from the date of notification of the award rather than from the date on which the award was made.

The meeting rose at 12.30 p.m.

329th Meeting

Tuesday, 18 June 1985, at 2 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 2.05 p.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 and Add. 1-2, A/CN.9/264)

Article 31. Form and content of award (continued)

1. The CHAIRMAN said that the discussion seemed to be moving towards an agreement that article 31 should contain some definition of when an award became binding. One view

was that the date should be that of the rendering of the award and the other that it should be the date on which the award was received by one or other party, or if there were two dates, the later of the two.

2. Mr. HOLTZMANN (United States of America) thought that for simplicity's sake it would be better to select the date of the award, which was known and certain. The date of

receipt would require proof, and the later of two dates would require two sets of evidence. Any possible unfairness that might result from using the date of the award, such as the curtailment of the period for recourse, could be remedied in the later articles.

3. Mr. LOEFMARCK (Sweden) doubted whether there was any point in specifying that an award became binding on a certain date. If other delegations felt strongly that a date should be set, however, his delegation would not object.

4. Mr. GRIFFITH (Australia) also felt that the proposed addition was unnecessary. If there must be a date, however, it should be that of the award.

5. Mr. SAWADA (Japan) believed that if a date had to be determined, it should be the date on which the party was informed of the award, and possibly several different dates because there might be several different parties. It would seem very strange if the award were to become binding without the parties knowing of it. He was still not certain, however, that any date should be set.

6. Mr. de HOYOS GUTIERREZ (Cuba) endorsed the principle of the Czechoslovak proposal but felt that a definite time should be set for the award to become binding, in other words, to have the force of *res judicata* and be enforceable in courts. A period of time must elapse, however, before an award became final. His delegation therefore considered that the proposal would be acceptable if it was made clear that the award would only become binding three months after the time of its receipt.

7. Mr. MTANGO (United Republic of Tanzania) was also doubtful as to the advantage of specifying a date on which the award would be regarded as binding. If the consequences of the award had to run from a certain date, however, that date must be the one on which the party received it. Questions of enforcement and setting aside were involved, and if a date was set, it must be that on which the award was actually received by the party concerned.

8. Mr. VOLKEN (Observer for Switzerland) said that the point at issue was whether a specific date was actually necessary. The Model Law contained three articles for which such a date could be useful, namely articles 33, 34 and 36. In article 33 (1), which dealt with the correction and interpretation of awards, a date was specified, namely "within thirty days of receipt of the award". In article 34 (3), on application for setting aside, there was again a specific time period, namely "an application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the award". Article 36, on grounds for refusing recognition or enforcement, contained in its paragraph (1) (a) (v) a provision to the effect that recognition or enforcement could be refused at the request of the party against whom it was invoked if there was proof that the award had "not yet become binding". If the Model Law did not anywhere define the point of time at which an award became binding, a party making a request for refusal on those grounds would not know when that point was. He felt, therefore, that it was necessary to specify the time somewhere in the Model Law and agreed with those representatives who were in favour of the date of the award itself.

9. Mr. SCHUMACHER (Federal Republic of Germany) supported the Czechoslovak proposal; the question of when an award became binding was an important one, and it was inappropriate for it to be dealt with only implicitly, through

article 35. His delegation considered that the time should be the latest date of receipt by the parties.

10. Mr. RICKFORD (United Kingdom) agreed with the doubts that had been expressed as to the desirability of specifying a date in the Model Law. If the general feeling was that a date should be determined, a number of considerations should be taken into account. The uniform rules of the Model Law ought to be subject to the agreement of the parties, who might wish to delay the binding effect of the award between themselves until after the expiry of a certain period. Room should also be left for the award itself to state that it was not binding until a certain time had elapsed. If some presumptive date was required, however, his delegation would endorse the view of the Federal Republic of Germany. The United States proposal had considerable value in terms of certainty, but it was difficult to reconcile with article 36 (1) (a) (v). On the whole, however, his delegation had grave doubts as to the wisdom of adding such a rule.

11. Mr. STROHBACH (German Democratic Republic) supported the Czechoslovak proposal to the effect that it should be expressly stated that an award was definite and binding on the parties. As to the date on which that should occur, he shared the view of the United States representative as being the most practical way of arriving at a uniform date and preventing additional subsequent disputes. He did not think that it would be helpful to bring up the question of party agreement. He therefore proposed that the date should be that of the award itself, without leaving open any possibility for the parties to prescribe an additional period. He did not think it would be necessary to make any change in article 36, since that article referred to the recognition or enforcement of awards made under the Model Law and under other systems.

12. Mr. HOLTZMANN (United States of America) agreed with the Observer for Switzerland that, if a definition of when an award became binding was needed in the Model Law, it was for the purposes of article 36. If no provision was made in the Model Law, the matter might be covered by local law, which might require filing, registration and so on. Accordingly, a provision stating that an award became binding at the moment it was signed by the arbitrators would be helpful. The necessity of proving receipt, which would arise if the last date of delivery was accepted, could cause many practical difficulties, especially where time was an important consideration.

13. Mr. TORNARITIS (Cyprus) agreed in principle with the Czechoslovak proposal. In order, however, to cover certain legal effects governed by other provisions of the Model Law, it might be well to state that the award became binding from the date on which it was rendered, unless otherwise provided by law.

14. Mr. PAULSSON (Observer for the Chartered Institute of Arbitrators) endorsed both the Czechoslovak proposal and the United States suggestion in regard to a date. He noted that in French law the matter had been considerably developed. There had been many cases in French judicial practice prior to 1980 in which the finding was that an award was binding as from the moment it was rendered. A provision to that effect, included in the law on arbitration, which had been adopted in 1980, had become very important in practice and was frequently invoked. The rendering of an award created certain abstract rights which could be of great interest and which did not necessarily require for their existence an awareness on the part of the party which enjoyed them.

15. Mr. LAVINA (Philippines) thought that the formula proposed by the United States delegation was both practical and realistic and would result in a uniform date. He agreed that it was also necessary for the purposes of article 36 (1) (a) (v).

16. The CHAIRMAN noted that some delegations considered that it was useful and necessary to fix a date on which an award became binding, though omitting the reference to *res judicata* and enforceability, while others felt that such a provision would not be very useful. As for the actual time to be set, there seemed to be a slight majority in favour of the date of the rendering of the award.

17. Mrs. RATIB (Egypt) said that her delegation considered that the date should be that on which the parties received notification of the award.

18. Mr. LOEFMARCK (Sweden) said that his delegation would prefer the date of the award. At the same time, if a specific date was decided on, it would be necessary to clarify what was meant by an award that was binding.

19. Mr. MTANGO (United Republic of Tanzania) agreed that it would be necessary to know the meaning of "binding" before deciding on a date. Delegations would have to be clear on that point in order to advise their Governments, which might be considering adopting the Model Law.

20. Mr. BONELL (Italy) felt that the Commission could not embark at that stage on a discussion of the implications of the binding effect of an award. His delegation would favour including a provision drafted on the lines suggested by the delegations of the Soviet Union and the United States and specifying the date of the rendering of the award.

21. Mr. ROEHRICH (France) said that, if the provision was included, the date set should be that of the award, as being the only known and certain date.

22. Mr. GRAHAM (Observer for Canada) said that it was customary in many countries to specify in the arbitration agreement when precisely an award became binding. As far as the Model Law was concerned, if the last date of receipt was taken as the relevant one, the problem would remain of ascertaining that date. The point could be solved by the provision in article 2 (e) which laid down when a written communication should be deemed to have been received. While his delegation would prefer the United States suggestion, it would therefore not object strongly to the proposal to use the date of receipt.

23. Mr. TORNARITIS (Cyprus) still believed that a distinction should be made between the validity of the award and its legal consequences. It should be stated that the award became valid as from the date of its rendering and that it produced its legal effects at that time, unless otherwise expressly provided in "this Law".

24. The CHAIRMAN said that since it was apparently not possible to satisfy all points of view, the Commission would have to keep the text as it stood and not insert a new paragraph. The report would state that there had been a lengthy discussion, with several delegations in favour of inserting a provision of the kind proposed, some of them being in favour of specifying the time of the award, others the time of its receipt by the parties and, in the case of one delegation, the time of the expiry of the period laid down for making application to set aside the award. If there were no objection, he would take it that the Commission agreed to approve article 31 on that basis.

25. *It was so agreed.*

Article 32. Termination of proceedings

Article 32 (1)

26. Mr. LEBEDEV (Union of Soviet Socialist Republics) drew attention to his delegation's written comment in document A/CN.9/263 (p. 44). The Commission had already approved in article 30 (1) the principle that if there was a settlement between the parties, the proceedings should be terminated by the arbitral tribunal. For the sake of consistency with that, the reference to the agreement of the parties should be transferred from paragraph (1) of article 32 to paragraph (2). He thought that was only a drafting point. Also, by describing the award as "final", the article introduced a new concept.

27. The CHAIRMAN said that he regarded the points raised by the Soviet Union representative as a drafting matter. If that representative saw no objection, they would be referred to the drafting committee.

28. *It was so agreed.*

Article 32 (2)

29. Mr. MTANGO (United Republic of Tanzania) questioned the inclusion of the proviso in paragraph (2) (a). If the claimant withdrew his claim, there was no longer a dispute. Even if that assumption was wrong, there was still the matter of costs. If the respondent insisted on the proceedings continuing, could the original claimant be held responsible for the costs arising out of that insistence? How could that matter be settled? He would like the proviso to be deleted.

30. Mr. HERRMANN (International Trade Law Branch) said that the Working Group on International Contract Practices had discussed the point raised by the representative of the United Republic of Tanzania and had decided that the arbitral tribunal should be given a certain discretion in the matter. As between the parties, the withdrawal of a claim might mean either a withdrawal from the current proceedings to enable the claimant to bring the dispute before another tribunal or a waiver of the rights alleged in the claim. It was not the intention of the Model Law to pronounce on that point. However, the Working Group had realized that the other party might have a certain interest in the current proceedings being pursued in order to reduce the risk of harassment by a claimant repeatedly bringing a claim and then withdrawing it. The question of costs was directly involved, and there had been a proposal to include a reference to liability for them in the text. That had not been done, because in general the Working Group had been reluctant to deal with the matter of costs in the Model Law. The present formulation of paragraph (2) (a) was an attempt to describe instances in which, in the objective judgement of the arbitral tribunal and not only in the view of the respondent, the latter had a legitimate interest in obtaining a final settlement of the dispute.

31. Mr. MTANGO (United Republic of Tanzania) said he still felt that the provision was open to abuse by the respondent: cases might occur, for example, in which the latter insisted on the proceedings continuing before an arbitral tribunal which was subsequently found incompetent. However, he would not press the point.

32. Mrs. RATIB (Egypt) said that paragraph (2) (b) provided the following: "when the continuation of the proceedings ...

becomes unnecessary or inappropriate" the arbitral tribunal "may issue an order of termination". The word "may" indicated a right and not an obligation. It followed that in spite of its conviction that the proceedings were unnecessary or inappropriate, the arbitral tribunal might, for reasons unspecified in the text, order them to be pursued. It was clear that the continuation of such proceedings could only be a waste of time and money. She therefore proposed that paragraph (2) should be amended to read:

"(2) The arbitral tribunal shall issue an order for the termination of the arbitral proceedings when:

"(a) the claimant withdraws his claim... [text unchanged];

"(b) the continuation of the arbitral proceedings for any other reason becomes unnecessary or inappropriate."

33. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that the meaning of the word "inappropriate" was not sufficiently clear. In the corresponding text in the UNCITRAL Arbitration Rules (article 34 (2)), the phrase used was "unnecessary or impossible". He suggested that the drafting committee might consider replacing the word "inappropriate" by the word "impossible".

34. Mr. SAMI (Iraq) supported the Egyptian proposal.

35. The CHAIRMAN said that the Egyptian proposal was one of substance. Perhaps wording such as the following might make it clear that it was for the arbitral tribunal to decide whether continuation was unnecessary or impossible: "The arbitral tribunal shall issue an order of termination when it finds that the continuation of the proceedings for any reason is unnecessary or impossible." If there was no objection, he would send the paragraph to the drafting committee for reformulation along those lines.

36. *It was so agreed.*

Article 32 (3)

37. *The Commission did not comment on paragraph (3).*

Article 33. Correction and interpretation of awards and additional awards

Article 33 (1)

38. Mr. HUNTER (Observer for the International Bar Association) said that as a practitioner he was concerned about the power of the arbitral tribunal under paragraph (1) (b) to interpret its award. He therefore supported the written proposal of the German Democratic Republic (A/CN.9/263, p. 45 (article 33), para. 1) that it should not be dealt with in the Model Law. He felt that subparagraph (b) might encourage an unseemly race between the winning party to request an interpretation, if he perceived any grounds in the text of the award for his opponent seeking to annul it, and the losing party to bring an action for recourse. He would therefore prefer paragraph (1) (b) to be deleted, but if the Commission wished to retain it, he hoped that it would be made non-mandatory by the addition of the formula "unless the parties otherwise agree".

39. Mr. GRIFFITH (Australia) agreed that the parties should be able to exclude the application of paragraph (1) (b).

40. Mr. HOELLERING (United States of America) said that his delegation too had had second thoughts about the

desirability of giving the arbitral tribunal power to interpret its award. The provision invited attempts on the part of both the winner and the loser to get changes made in the merits of the award. While that might be acceptable by agreement between the parties, it should not occur at the unilateral request of one of them. That would encourage further proceedings and undermine the principle of the finality of the arbitral award. Furthermore, if the intention of the Commission was to harmonize arbitral law, he was not aware of any statute containing such a provision.

41. Mr. MIANGO (United Republic of Tanzania) said that he shared the views expressed by the previous speakers. In addition to the problems already mentioned, there were also the questions whether the interpretation could be contested and when it would become part of the award. It would be better to delete subparagraph (1) (b).

42. Mr. de HOYOS GUTIERREZ (Cuba) said he would prefer the provision to be amended. Various arbitration rules authorized an arbitral tribunal to clarify a specific point or part of an award.

43. Mr. ROEHRICH (France) drew attention to the fact that interpretation of an award was possible under article 35 (1) of the UNCITRAL Arbitration Rules. The principle of interpretation of decisions was also admitted in the judicial system, in order to avoid subsequent litigation. He could therefore approve the text as it stood, provided that a very short time-limit was imposed. He would have no objection to making the provision non-mandatory.

44. Mr. STROHBACH (German Democratic Republic) said that under paragraph (1) (b) the losing party had the right to seek interpretation of merely a part of the award. Over what period of time should he be able to exercise that right? In his view, the provision must either be deleted or be amended to make it more precise and to limit action by the losing party designed solely to postpone compliance with the award. He would prefer deletion, because he thought that the needs of the parties were sufficiently met by the possibility of the arbitral tribunal making corrections and additional awards.

45. Mr. MOELLER (Observer for Finland) said he also felt that the subparagraph should be deleted. Finland had had such a provision in its legal system but it had not functioned satisfactorily and it had been repealed. He could also support the Czechoslovak written suggestion to restrict the provision (A/CN.9/263, p. 45 (article 33), para. 1), but that proposal would not satisfy those who wanted the arbitral tribunal to retain its power of interpretation. A possible compromise would be to make interpretation subject to the agreement of both parties. In that case the arbitral tribunal should give the other party an opportunity to comment before it made its interpretation. However, that would entail prolonging the period of time specified.

46. Mr. NEUTEUFEL (Austria) endorsed the comments of the Observer for the International Bar Association.

47. Mr. RUZICKA (Czechoslovakia) said that while he saw no justification for deleting the subparagraph, it might be desirable to limit the permissible interpretation to interpretation of the reasons upon which the award was based, as had been suggested in his Government's written comments. Interpretation of the award itself might result in a reopening of the case and the drawing-up of a new award.

48. Mr. JOKO-SMART (Sierra Leone) favoured the retention of the subparagraph, although the word "interpretation", if

taken in its strict legal sense, was perhaps too strong; the parties should be given an opportunity to ask for a clarification or explanation of the award.

49. Mr. LOEFMARCK (Sweden) said there might be a justification for the provision in the fact that the losing party or the enforcement authority might not know how they were required to act. If the provision was retained, therefore, it should not be restricted to the reasons upon which the award was based. However, he was in favour of its deletion.

50. Mr. SCHUMACHER (Federal Republic of Germany) also favoured the deletion of the provision. A request for an explanation on specific points might give the losing party an opportunity to make the arbitral tribunal waste time unnecessarily. A possible compromise would be to make the provision subject to the agreement of both parties, but he would prefer its deletion.

51. Mr. SEKHON (India) said that he favoured the deletion of the provision since it could be abused and might frustrate one of the basic aims of arbitration, which was the speedy resolution of disputes. He could accept a compromise wording allowing both parties to agree to seek a clarification of the award. There was not much justification for the provision to refer specifically to the reasons for the award, since that matter was already covered by article 31 (2).

52. The CHAIRMAN asked whether the Commission was prepared to accept the retention of subparagraph (1) (b), subject to its reformulation by the drafting committee to contain a proviso that both parties should have agreed before the award was made to allow an interpretation of it by the arbitral tribunal, or should by common accord ask for an interpretation after the award had been made.

53. *It was so agreed.*

54. Mr. GRIFFITH (Australia) said that he agreed with the suggestion made by Sweden and the United States in their written observations (A/CN.9/263, p. 45 (article 33), para. 3) that an arbitral tribunal which had received a request from a party under article 33 should give the other party an opportunity to respond to the request. That should be implicit from a reading of article 19 (3), and a provision to that effect need not be incorporated in article 33 (1), but he wished to make it clear that that was how the article should be interpreted. Article 33 (3) stipulated that the arbitral tribunal should make an additional award "if it considered the request to be justified", and that proviso should apply to correction and interpretation as well. He therefore suggested that the words "if it considers the request to be justified" should be added at the end of the penultimate sentence of article 33 (1).

55. The CHAIRMAN said that article 33 (1) should not be read to mean that the arbitrators had to comply blindly with requests by the parties; it was clear that they were expected to exercise discretion.

Article 33 (2)

56. Mr. HOELLERING (United States of America) said that there should be one period during which the other side could object to a request and another during which the arbitrators could act after a party had filed its objection or after the date for filing had expired.

57. Mr. ROEHRICH (France) said that article 33 (2), when read in conjunction with articles 19 (3) and 33 (1), could have

the effect of facilitating the reopening of a case under the pretext of a request for a correction. However, if drafting changes were made to prevent such an interpretation, they would complicate still further an already complex article.

58. The CHAIRMAN said that it would be placed on record that the Commission did not desire to make any changes in the text of the paragraph.

Article 33 (3)

59. Mr. SEKHON (India) said that a party other than the one requesting the additional award should be able to file an objection or be given a hearing on the matter; that was in accordance with both common law and civil law procedure.

Article 33 (4) and (5)

60. *The Commission did not comment on paragraphs (4) or (5).*

Article 35. Recognition and enforcement (continued)

Article 35 (3) (continued)

61. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that the Working Group on International Contract Practices had decided to insert the paragraph in the draft text for sound reasons connected with the structure of the Model Law and its relationship with the 1958 New York Convention. The Commission, in acceding to the objections raised to the paragraph at its 320th meeting, might perhaps have overlooked those considerations. He felt that the Model Law should state explicitly what article 35 (3) stated. He therefore urged the Commission to give serious consideration to reversing the decision in which it had decided to delete the subparagraph.

62. The CHAIRMAN said that the Commission would not wish to overturn one of its decisions without very strong reasons for doing so. Unless he heard any objection, he would take it that the Commission maintained its decision to delete article 35 (3).

63. *It was so agreed.*

64. Mr. HOLTZMANN (United States of America) said that his delegation wished to register its dissatisfaction that insufficient time was being provided for a discussion of the important points raised by article 35 (3) and to which the Observer for ICCA had drawn attention.

Article 36. Grounds for refusing recognition or enforcement (continued)

Article 36 (1)

65. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) said that, having decided to deal with both domestic and foreign awards in the Model Law, the Commission must remember that the same provisions should not always apply to both; the grounds for refusal that had to be proved by the parties should not be the same in both cases, and the grounds for refusal set out in article 36 (1) (b) should not be compulsory for domestic awards. To make that distinction clear, article 36 should be reworded; it was already difficult to read as it was, however, and redrafting might

make it all the more complex. Another possibility would be to make article 36 apply solely to foreign awards and to add a new article 37 which would reproduce the language of article 36 but be applicable only to domestic awards; that would create repetition in the text but render it easier to grasp.

66. Mr. VOLKEN (Observer for Switzerland) proposed that the words "irrespective of the country in which it was made" be deleted and the word "foreign" be inserted before the words "arbitral award" in article 36 (1). The Model Law would then mirror the 1958 New York Convention by applying only to foreign awards.

67. Mr. LOEFMARCK (Sweden) said that from a logical point of view, foreign awards should be dealt with separately from domestic awards; from a practical point of view, however, he doubted whether that was in the interest of individual countries. He would advocate leaving the text of article 36 as it was.

68. Mr. ROEHRICH (France) said that he too favoured leaving the text as it was. The Model Law was intended to apply to international commercial arbitration and it was of no use to limit article 36 to foreign awards, especially as it established similar grounds for refusal of enforcement as did article 34 for setting aside.

69. Mr. SZASZ (Hungary) said that one of the main points raised during the discussion of article 35 had been that the Model Law was not a simple repetition of the 1958 New York Convention but an innovation in that it established a unified common régime for international commercial arbitration. If the scope of article 36 was to be limited to foreign awards as understood under the 1958 New York Convention, articles 35 and 36 would be entirely superfluous and could be deleted. The Commission should seek, rather, to establish a system for

recognition and enforcement which was completely different in scope from that of the 1958 New York Convention but which incorporated the lessons learned from its application.

70. Mr. BONELL (Italy) said that he endorsed the comments made by the representative of Hungary.

71. Mr. VOLKEN (Observer for Switzerland) said that, in view of the remarks of the representative of Hungary, he withdrew his proposal.

72. Mr. LOEFMARCK (Sweden) said that in some jurisdictions, notably the Swedish and Finnish, it was not a court but another authority which was involved in the enforcement of domestic awards. He therefore suggested that the words "or other authority" be inserted after the words "competent court" in article 36 (1) (a).

73. Mr. MOELLER (Observer for Finland) said that he felt the problem was solved by the definition of "court" given in article 2 (c).

74. Mr. BOGGIANO (Observer for Argentina) recalled the question of the jurisdiction of the arbitral tribunal which had been raised during the discussion of article 1 (2) (c). If a dispute could be made international merely by the will of the parties, recourse to arbitration could be a means for them to escape the jurisdiction of the country in which the dispute had arisen. Under article 36 (a) (i), however, the court in which enforcement was sought might wish to challenge an agreement on arbitral jurisdiction reached by the parties if it felt that it represented an attempt to evade the jurisdiction of a country with which the dispute was directly linked. He referred in addition to his country's written observations (A/CN.9/263, p. 53, para. 1) on how the article should be interpreted.

The meeting rose at 5 p.m.

330th Meeting

Wednesday, 19 June 1985, at 9.30 a.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 9.35 a.m.

International commercial arbitration (continued)

A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264; A/CN.9/XVIII/CRP.9, 11, 12)

Article 36. Grounds for refusing recognition or enforcement (continued)

1. Mr. PELICHET (Observer for The Hague Conference on Private International Law) said that, since the Commission had decided to delete the phrase "under the law applicable to them" from article 34 (2) (a) (i), the same phrase should be deleted from article 36 (1) (a) (i).

2. Mr. BOGGIANO (Observer for Argentina) supported that suggestion which conformed with the current trend towards greater party autonomy.

3. Mr. MTANGO (United Republic of Tanzania) said that his delegation had opposed the deletion of the phrase "under the law applicable to them" in article 34 (2) (a) (i); it could not now support the same amendment to the article under discussion.

4. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that it should be made clear in the Commission's report that the amendment was only a drafting change and did not affect the interpretation of the 1958 New York Convention.

5. Mr. LOEFMARCK (Sweden), speaking on article 36 (1) (a) (v), asked what would happen if enforcement of a foreign arbitral award were sought as soon as the award became binding, but before the expiry of the three-month period for instituting setting-aside proceedings. The competent court might, for instance, find errors which could cause the award to be set aside, or it might know that setting-aside proceedings had already been initiated. The point should be raised in the Commission's report so that States adopting the Model Law could introduce appropriate national legislation if necessary.

6. The CHAIRMAN said that, under his country's legal system, enforcement could be suspended if the competent court thought it likely that a claim for setting aside would be brought. The Model Law should not contain a specific reference to the enforcement of foreign arbitral awards since

such a provision might conflict with existing national legislation. The point would, however, be covered in the report.

7. Mr. SEKHON (India) said that the concept of "public policy" existed also in States with a civil law system, but referred essentially to the law of contracts. His delegation therefore suggested that subparagraph (b) (ii) should be deleted from article 36 (1).

8. Mr. HERRMANN (International Trade Law Branch) said that in the corresponding subparagraph (b) (ii) of article 34 (2) the Commission had decided to retain the term "public policy", but to indicate in the report the possible interpretations of that term. The Commission had also decided to bring the wording of article 34 (2) (a) (ii) into line with that of article 19 (3) by inserting a reference to the principle of equal treatment of the parties.

9. Mr. GRAHAM (Observer for Canada), supported by Mr. RICKFORD (United Kingdom), said that his delegation had understood the term "public policy" in the sense of the French "*ordre public*", rather than in the restricted common law sense.

10. The CHAIRMAN said that, if there were no objections, he would take it that the Commission agreed to delete the phrase "under the law applicable to them" in article 36 (1) (a) (i) and to retain the reference to "public policy" in article 36 (1) (b) (ii).

11. *It was so agreed.*

Article 15. Appointment of substitute arbitrator (continued)
(A/CN.9/XVIII/CRP.11)

12. Mr. HERRMANN (International Trade Law Branch) said that the document under discussion (A/CN.9/XVIII/CRP.11) had been prepared before the Commission had reached a final decision on the text of article 14. Since, however, it had been decided to leave article 14 in its original form, the amendment to article 15 contained in that document was no longer necessary.

13. Mr. SEKHON (India), speaking on behalf of the *Ad Hoc* Working Party, withdrew the amendment.

Article 1. Scope of application (continued)
(A/CN.9/XVIII/CRP.12)

14. Mr. HERRMANN (International Trade Law Branch), introducing the secretariat proposal on a new paragraph (1 *bis*) for article 1 (A/CN.9/XVIII/CRP.12), said that it gave expression to the Commission's tentative decision to adopt a strict territorial scope of application for the Model Law. It had been decided that the provisions of the Model Law would apply where the place of arbitration was in the particular State which had adopted it, except for articles 8, 9, 35 and 36, which would apply irrespective of the place of arbitration. On another point, the Commission had not as yet decided whether the court assistance referred to in articles 11, 13 and 14 should be made available even before the place of arbitration had been determined; if it decided that issue in the negative, the proposed new paragraph (1 *bis*) would take a much simpler form, which was presented as an alternative in document A/CN.9/XVIII/CRP.12.

15. Since article 1 (1 *bis*) would thus explicitly state that articles 8, 9, 35 and 36 were excepted from the strict territorial

scope of application, there was a risk of misinterpretation if the global scope of application in some of those articles were explicitly restated. If the Commission wished to make the point clear in respect of articles 35 and 36, the heading of chapter VIII of the Model Law could be amended to indicate that the articles in that chapter covered recognition and enforcement of awards irrespective of the countries in which they were made.

16. The CHAIRMAN said that the Commission had tentatively decided to include a provision on the territorial application of the Model Law if it could agree on a suitable text, and otherwise to keep the original text, despite the risk of varying interpretations.

17. Mr. ROEHRICH (France) supported the inclusion of a provision on territorial scope of application and expressed a preference for the second, shorter version of the new paragraph (1 *bis*). However, his delegation had doubts about the further criteria which had been suggested for the court functions mentioned in articles 11, 13 and 14, namely the place of business of the claimant or the respondent, and felt that a better definition was needed of the court which would provide the assistance. The shorter version of the proposed new paragraph (1 *bis*) would not allow for court assistance before the place of arbitration had been determined, but that assistance was rarely requested at such an early stage.

18. Mr. SZASZ (Hungary) endorsed the comments of the representative of France. It was essential for the Model Law to include a rule on the territorial scope of application, and he supported the shorter of the two versions submitted. He welcomed the secretariat's submission of two drafts, since it would be important for those drafting national law to read the discussion and understand the reasons that had led to the Commission's decision.

19. Mr. BONELLI (Italy), while appreciating the arguments advanced in favour of the shorter text, supported the longer version. In the first place, the words "except articles 8, 9, 35 and 36" in the shorter text could be misconstrued as meaning that those articles would apply only if the place of arbitration was not in the territory of the State concerned. His main reason, however, was that the longer version provided for cases where court assistance was needed but the place of arbitration had not yet been determined. It was true that the Commission had to decide whether to deal with such cases or not, but he felt that a provision on the subject should, if possible, be included. The secretariat's proposal was realistic and could meet many, if not all, of the circumstances which might arise in practice. There might be problems with the intervention of different courts in the same arbitral proceedings, but they would not be avoided by ignoring them. It was not always possible for the parties to determine the place of arbitration, and in those cases the court would have to decide. A further reason for preferring the longer version was its provision that, in that context, the criterion should be the place of business of the respondent.

20. The CHAIRMAN suggested that the first point raised by the representative of Italy might be solved if the longer version was taken and it was specified that the provisions of the law should apply "only" if the place of arbitration was in the territory of the State.

21. *It was so agreed.*

22. Mr. PELICHET (Observer for The Hague Convention on Private International Law) said that, for technical reasons of legislative drafting, he had serious doubts about the value

of the proposed paragraph. The Model Law would be incorporated into national law and, in that context, to state that a law would apply in the country adopting it would be to state a legally self-evident proposition. With the proposed paragraph, it might be argued by a *contrario* reasoning that a legislator adopting the Model Law would, for example, not allow parties abroad to use the Model Law for their arbitral proceedings. In his opinion, the proposed article would not serve any useful purpose.

23. Mr. HOLTZMANN (United States of America) agreed with the representative of Italy that, if possible, it would be useful if the Model Law could provide for cases where the parties had not agreed on the place of arbitration. He had reluctantly concluded, however, that at the present juncture—and without a working group to deal with the complexities of the problem—it was not feasible to address that situation.

24. Among the problems that would have to be resolved was whether the court chosen to provide assistance should be that of the claimant or that of the respondent, or some other court. He could not agree to the choice of the respondent's court. For reasons which he would not explain unless the longer version were adopted for the new paragraph, he felt that its provisions were inconsistent with those of the existing article 1. He therefore supported the shorter version, on the understanding that the Italian representative's drafting point and the Chairman's solution, to which he agreed, would be referred to the drafting committee.

25. He suggested that it should be noted in the report that questions of assistance in situations covered by articles 11, 13 and 14 were clearly not matters governed by the Model Law. It was up to the parties to solve that problem—a resolution that was possible if the parties showed goodwill—otherwise they would be left only with any remedies available under domestic laws.

26. *It was so agreed.*

27. Mr. STROHBACH (German Democratic Republic) said that he was in favour of having a new paragraph and supported the shorter version, with the Italian drafting amendment.

28. Mr. BROCHES (Observer, International Council for Commercial Arbitration) supported the idea of a general article and also preferred the shorter version. He agreed with the territorial scope of application as defined elsewhere in the Model Law.

29. Mr. VOLKEN (Observer for Switzerland) said that he did not entirely agree with The Hague Conference Observer, because national law could perfectly well contain a rule governing its scope of application or restricting that scope; the latter would be a self-limiting rule.

30. Regarding the secretariat's proposal, he preferred the shorter version but suggested that it should be couched in more general terms, without listing the articles, on the following lines: "The provisions of this Law apply if the place of arbitration is in this State or if a court of this State is called upon to solve a legal question concerning arbitration". That would cover all the cases where a court of the State in question was called upon to settle an issue related to a case of international commercial arbitration.

31. The CHAIRMAN suggested that the proposed amendment, which was a matter of presentation, should be left to the drafting committee.

32. *It was so agreed.*

33. Mr. MOELLER (Observer for Finland), while not disagreeing with The Hague Conference Observer that the rule in the proposed new paragraph was self-evident, felt that it was nevertheless a useful provision. He supported the shorter version, subject to drafting.

34. Mr. LOEFMARCK (Sweden) endorsed the views of the representative of Italy. While he would prefer the longer version for the new paragraph, he would bow to the majority if it was in favour of the shorter one. He regretted, however, that the latter would rule out the possibility of using the court specified in the Model Law.

35. Mr. LEBEDEV (Union of Soviet Socialist Republics) expressed regret that so little time was left to deal with a very important issue. In that regard, he drew attention to his delegation's proposal in its comments under article 6 (A/CN.9/263, p. 8, para. 5). That proposal was close to the idea—mooted during the discussion—of combining the territorial criterion and party agreement. In the circumstances, however, he was prepared to join the majority in supporting the shorter version for the new paragraph on the understanding, indicated by the United States representative, that the case where the place of arbitration had not yet been agreed upon should remain outside the scope of the Model Law.

36. Mr. MTANGO (United Republic of Tanzania) shared the Soviet Union representative's regret that there was not sufficient time to study the implications of the present issue. He therefore preferred the approach suggested by the United States representative and elaborated upon by the Soviet Union representative.

37. Mr. SAWADA (Japan) also supported the shorter version but agreed with the Soviet Union representative that if the place of arbitration were not yet decided, rather than declare that court assistance was not available under articles 11, 13 and 14, it would be better to leave the matter to the law of the State concerned.

38. The CHAIRMAN said he took it that the Commission agreed that the shorter version of the new paragraph (1 *bis*), subject to drafting changes, should be referred to the drafting committee.

39. *It was so agreed.*

Article 27. Court assistance in taking evidence (continued)

40. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that, as he understood it, the adoption of the new paragraph (1 *bis*) for article 1 in the shorter version would also settle the question left pending under article 27. In that connection, he drew attention to the Soviet delegation's suggestion to delete the words "under this Law" (A/CN.9/263, p. 38, para. 1).

41. The CHAIRMAN suggested the deletion of the whole of the opening phrase "In arbitral proceedings held in this State or under this Law"; the article would then read: "The arbitral tribunal or a party . . .". There was no need to repeat the principle of territoriality because it was now embodied in the new paragraph (1 *bis*) of article 1.

42. *It was so agreed.*

Article 8. Arbitration agreement and substantive claim before court (continued)

43. Mr. BROCHES (Observer for the International Council for Commercial Arbitration) supported the Secretariat suggestion concerning the chapter heading relating to article 8.

44. The CHAIRMAN said that he doubted whether any change was really necessary because the new paragraph (1 *bis*) of article 1 specified that the territorial restriction did not apply to articles 35 and 36.

45. Mr. SZASZ (Hungary), supported by Mr. LEBEDEV (Union of Soviet Socialist Republics), asked whether the footnote to the title of article 1 and the article headings generally would be retained in the final version of the Model Law.

46. Mr. HERRMANN (International Trade Law Branch) explained that, since practice differed, it had been thought useful in the Model Law to indicate that the headings did not form part of the Commission's decision but had been added for reference purposes only and should not be used for purposes of interpretation. It was for each State to decide if it wanted to indicate the purpose of the headings.

47. The CHAIRMAN said he took it that there was no objection to keeping the footnote.

48. *It was so agreed.*

Article 2. Definitions and rules of interpretation (continued)
(A/CN.9/XVIII/CRP.13)

49. The CHAIRMAN said that, since there were no comments, he would take it that the Commission agreed to adopt the proposal by the delegation of the German Democratic Republic and the Observer of The Hague Conference on Private International Law (A/CN.9/XVIII/CRP.13).

50. *It was so agreed.*

Article 19. Determination of rules of procedure (continued)

Article 19 (2)

51. Mr. MTANGO (United Republic of Tanzania) recalled that the Commission, at its 316th meeting, had decided to postpone consideration of the paragraph until completion of the consideration of article 28 (A/CN.9/SR.316, paras. 76-77), and that the United States delegation had been requested to submit a text for consideration by the Commission.

52. Mr. HOLTZMANN (United States of America) said that his delegation had not prepared a text but thought that the written proposal made by the International Chamber of Commerce (ICC) on article 7 (A/CN.9/263/Add.1, p. 7, para. 8) might be used, though not necessarily in article 19, but with the following amendments: the words "administered by a permanent arbitral institution" should be replaced by "under particular arbitration rules"; the words "(the rules of such arbitral institution)" should be replaced by "such rules"; and the words "mandatory provisions of this Law" should become "the provisions of this Law from which the parties cannot derogate".

53. The aim of the ICC proposal was to make the Model Law even clearer concerning the importance of arbitration rules.

However, the inclusion of the provision was not absolutely necessary since the Model Law emphasized the right of the parties to make agreements, including agreements concerning arbitration rules.

54. The CHAIRMAN noted that article 19 (1) and article 2 (d) both implied that agreement between the parties concerning arbitration rules formed a part of the agreement of the parties. Perhaps the Commission's report should note that that was the common understanding on the subject and that the ICC proposal had been omitted merely because it was not necessary.

55. Mr. BONELL (Italy) said that he agreed with the Chairman's comment on the implications of article 19 (1) and article 2 (d). During the earlier discussion on article 19, he had drawn attention to his Government's written comment on article 19 (2) (A/CN.9/263, p. 32, para. 4). The Commission should now consider deleting the second sentence of that paragraph. Otherwise, the difficulties referred to in his Government's submission might arise.

56. The CHAIRMAN suggested that the problem might be overcome by inserting the words "subject to article 28".

57. Mr. BONELL (Italy) said that if the Chairman's suggestion was accepted, he would withdraw his proposal for deletion.

58. Mr. HOLTZMANN (United States of America) said that one reason why parties chose arbitration was to be free of the technical rules of evidence, be they procedural or substantive. The aim of the Model Law was precisely to avoid the application of technical rules of evidence. He therefore thought that the Commission should adopt the Working Group's text.

59. The CHAIRMAN said that since there was little support for the deletion or amendment of the second sentence of paragraph (2), he would take it that the Commission agreed that the paragraph should remain unchanged.

60. *It was so agreed.*

Article 19 (3)

61. The CHAIRMAN recalled that the only point to be decided was whether article 19 (3) should remain where it was or be transferred to an earlier place in the text.

62. Mr. SAMI (Iraq), supported by Mr. MTANGO (United Republic of Tanzania) and Mr. RICKFORD (United Kingdom), said that article 19 (3) embodied a general principle that should govern all phases of the arbitration proceedings and not merely the two cases covered in paragraphs (1) and (2) of article 19. It should therefore be moved up in the text.

63. Mr. SEKHON (India) agreed with the representative of Iraq and noted that, in the event of relocation, the words "In either case" would have to be deleted.

64. Mr. LOEFMARCK (Sweden) said that the provision contained in article 19 (3) enshrined too important a rule to be hidden in article 19 under the heading "Determination of rules of procedure".

65. The CHAIRMAN suggested that article 19 (3) should be converted into a new article 18 *bis* and become the first article in chapter V, and that the drafting committee should propose a suitable heading for it. Article 19 would then follow under its present heading but with only two paragraphs. If there was no objection, he would take it that the Commission agreed to adopt that suggestion.

66. *It was so agreed.*

Article 12. Grounds for challenge (continued)
(A/CN.9/XVIII/CRP.9)

67. Mr. HOLTZMANN (United States of America) said that the *Ad Hoc* Working Party had reconsidered its proposal (A/CN.9/XVIII/CRP.9) and had concluded that there was some ambiguity as to whether the term "justifiable doubts" qualified the words "or as to any other qualification agreed by the parties". It now proposed that those words should be replaced by "or if he does not possess qualifications agreed by the parties".

68. The CHAIRMAN suggested that the Commission should accept the proposal by the *Ad Hoc* Working Party.

69. *It was so agreed.*

Article 34. Application for setting aside as exclusive recourse against arbitral award (continued)

and

Article 36. Grounds for refusing recognition or enforcement (continued)

70. Mr. GRIFFITH (Australia) said that if the drafting committee was to propose an amendment to article 34 (2) (a) (ii), a similar amendment would have to be made to article 36 (1) (a) (ii).

71. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that, as far as he remembered, the decision to request an amendment from the drafting committee applied only to article 34. No decision had been taken to include a similar amendment in article 36, especially since paragraph (1) (a) (ii) of that article deliberately reproduced the wording of the corresponding provision of the 1974 New York Convention (Article V (1) (b)). If such an amendment was made to article 36, the conditions of enforcement of an arbitral award would be more burdensome under the Model Law than under the 1958 New York Convention. That was not the Commission's intention.

72. Mr. HERRMANN (International Trade Law Branch) said that his understanding of the situation was that the Commission needed to take a decision as to whether article 36 should be made consistent with article 34 along the lines indicated by the representative of Australia.

The meeting rose at 12.35 p.m.

331st Meeting

Wednesday, 19 June 1985, at 2 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 2.05 p.m.

International commercial arbitration (continued)
(A/CN.9/246, annex; A/CN.9/263 and Add.1-2; A/CN.9/264)

Article 34. Application for setting aside as exclusive recourse against arbitral award (continued)

and

Article 36. Grounds for refusing recognition or enforcement (continued)

1. The CHAIRMAN said that the question had arisen whether the Commission should eliminate the disparity which it had created between articles 34 and 36; the former now incorporated a more extensive list of grounds for court action than the latter, which followed the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. As the 1958 New York Convention was not concerned with the question of setting aside, it might not be inappropriate for the Commission to accept differing formulations for the two articles.

2. Mr. ROEHRICH (France) said that he would prefer article 34 and article 36 to be worded identically. Even though the two articles were intended to serve different purposes, a disparity in their language might make their interpretation difficult. Moreover, the new article 18 *bis* set out a general rule on the conduct of arbitral proceedings which should meet the concerns of those who wanted article 34 to be more detailed.

3. Mr. SZASZ (Hungary) said that he agreed with the representative of France that articles 34 and 36 should be identical. The Commission's report should make it clear that anything not covered by article 18 *bis* was covered by those two articles.

4. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that he fully endorsed the comments made by the representatives of France and Hungary. It would be extremely difficult to amend article 34 (2) (a) (ii) by incorporating in it a reference to article 19 (1) or article 18 *bis* without duplicating the provisions of article 34 (2) (a) (iv).

5. Mr. DUCHEK (Austria) said that the interpretation of article 34 (2) (b) (ii) was that it did not refer exclusively to an award but also covered the procedures that led to an award. As long as that broad interpretation of "award" was clearly reflected in the Commission's report, he would favour the wording of article 34 as proposed by the Working Group on International Contract Practices.

6. Mr. RICKFORD (United Kingdom) said that his delegation would be reluctant to agree to any action by the Commission to align articles 34 and 36 that implied a reversal of its decision to expand the scope of article 34. However, the Commission might perhaps take the view that the purpose of that decision could equally well be achieved by the incorporation in the report of wording conveying the broad inter-

pretation of article 34 (2) (b) (ii). If so, his delegation could accept that as a substitute for the Commission's earlier decision.

7. Mr. GRIFFITH (Australia) said that, if that suggestion was adopted, the report should make it clear that any breach of the obligations imposed by article 18 *was* intended to be covered by the wording of article 34 (2).

8. The CHAIRMAN said that the course of action outlined by the representatives of the United Kingdom and Australia would allow the wording of article 34 to be brought back into line with that of article 36. He would therefore take it, unless he heard any objection, that the Commission wished to reverse its decision to expand the grounds for setting aside enumerated in article 34 (2) and, instead, to include in its report the wording referred to by the United Kingdom and Australian representatives.

9. *It was so agreed.*

Additional points suggested for inclusion in the Model Law

Counter-claim

10. Mr. HOLTZMANN (United States of America) said that he supported the written proposal made by the Government of Mexico (A/CN.9/263, p. 55, para. 1) for the inclusion in the Model Law of an express reference to counter-claims and defences to counter-claims. Although those steps were intended to be covered *mutatis mutandis* wherever the text spoke of claims and defences, they were often a very important part of arbitral procedure and should be mentioned specifically. That was proved by experience with the UNCITRAL Arbitration Rules, which did make an explicit reference to them. The matter was a question of suitable drafting.

11. Mr. RUZICKA (Czechoslovakia) endorsed the view expressed by the representative of the United States and drew attention to his own Government's written observations, which also contained a proposal for dealing with the matter (A/CN.9/263, p. 55, para. 3).

12. Mr. SEKHON (India) said that he too supported the view expressed by the representative of the United States. In the Indian legal system, a clear distinction was made between the procedural steps in question.

13. The CHAIRMAN said that the Commission seemed to favour the idea of including an express reference to counter-claims and defences to counter-claims in the Model Law. He suggested that all interested delegations should participate in drafting a form of words suitable for the purpose.

14. *It was so agreed.*

Burden of proof

15. Mr. HOLTZMANN (United States of America) drew attention to article 24 (1) of the UNCITRAL Arbitration Rules, which read: "Each party shall have the burden of proving the facts relied on to support his claim or defence." Although such a requirement might be self-evident to legal experts, its inclusion in the Rules had proved extremely useful in practice and should be included in chapter V of the Model Law.

16. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that his country had made a similar suggestion in its written observations (A/CN.9/263, p. 56, para. 9). The principle was truly important in practice and should be clearly enunciated in the Model Law. The wording read out by the United States representative would be suitable for the purpose.

17. Mr. MTANGO (United Republic of Tanzania) said he recognized the necessity for evidence to be produced in support of a claim or a defence, but he doubted whether it was appropriate for the Model Law to stipulate that the burden of proof fell on the parties. The Model Law was concerned with arbitral proceedings, which were different from court proceedings and aimed at reaching an amicable agreement between the parties. He would not object to a simple statement of the need for the parties to produce evidence, but he felt that to impose on them the burden of proving the facts relied on to support their claim or defence would be going unnecessarily into legal technicalities. He therefore had grave misgivings about duplicating the UNCITRAL rule in the Model Law. A milder version would not preclude the parties from agreeing to the burden of proof if they so wished.

18. Mr. de HOYOS GUTIERREZ (Cuba) said that it was an elementary principle of law that the burden of proof fell on the claimant. The principle applied to both judicial and arbitral proceedings and that was why it was included in the UNCITRAL Rules. He felt, therefore, that the Model Law should repeat the UNCITRAL provision, although even if it did not the rule would be followed in practice because it was a fundamental principle of law.

19. Mr. SCHUMACHER (Federal Republic of Germany) said that article 24 (1) of the UNCITRAL Rules expressed a fundamental principle of court proceedings. Since there was no reason why the principle should not apply in arbitrations also, his delegation supported the proposal to include it in the Model Law.

20. Mr. VOLKEN (Observer for Switzerland) pointed out that if such a provision was introduced, it might conflict with paragraphs (1) and (2) of article 19 and with article 28. The problem would be particularly acute in regard to the applicable law. Substantive law, for example, sometimes contained rules providing which of the parties must furnish a particular kind of evidence.

21. Mr. JOKO-SMART (Sierra Leone) supported the United States proposal: notwithstanding that the provision in article 24 (1) of the UNCITRAL Rules was common to most judicial systems, it should be included in the Model Law.

22. Mr. RAMADAN (Egypt) said that since it had been claimed that the principle of the UNCITRAL rule was already implicit in article 19 (2), the rationale for introducing it as a new paragraph seemed doubtful. Nor did the Model Law always have to follow the UNCITRAL Rules: for example, article 23 of the Model Law differed from article 18 of the UNCITRAL Rules. His delegation was not in favour of the proposal.

23. Mr. ROEHRICH (France) said that it was not clear what the relationship of the new provision would be to paragraphs (1) and (2) of article 19. Would it take precedence over paragraph (1), thus limiting the freedom of the parties to agree on the procedure to be followed by the arbitral tribunal? Would it even limit the freedom left to the arbitral tribunal by paragraph (2)? The proposal should perhaps be

examined more closely from that point of view. There were difficulties also with the text of the UNCITRAL rule. For example, what would the position be if the respondent relied on the same facts as the claimant? It might not be appropriate simply to reproduce the UNCITRAL rule. On the whole, therefore, he was opposed to its inclusion.

24. Mr. TANG Houzhi (China) said he did not think that the UNCITRAL rule should necessarily be incorporated in the Model Law. Since burden of proof was a matter common to all legal systems, its inclusion in the Model Law would be superfluous. His delegation therefore opposed the proposal.

25. Mr. LAVINA (Philippines) supported the proposal, for the reasons put forward by the representative of Cuba.

26. Mr. BOUBAZINE (Algeria) associated his delegation with those which opposed to the proposal to include the UNCITRAL rule in the Model Law.

27. Mr. STROHBACH (German Democratic Republic) said that his delegation supported the proposal. It was a question of transferring from the UNCITRAL Rules to the Model Law a point that should be made in the latter for the reasons stated in the written comments of the Soviet Union and the United States (A/CN.9/263, pp. 56-57). The provision might best be inserted as a new paragraph (3) of article 19.

28. Mr. SEKHON (India) said he felt that it would be unnecessarily burdening the Model Law to state such a self-evident proposition. It would also be likely to create difficulties in respect of articles 19 and 28. A further question was the evidence of the experts whom the arbitrators were empowered to call on. Such matters would be governed by the applicable law, in which the different provisions adopted by different countries would appear. His delegation therefore opposed the proposal.

29. Mr. SCHUMACHER (Federal Republic of Germany) endorsed the comment of the Observer for Switzerland about article 28. The application of the proposed rule should be subject to the relevant provision of the applicable substantive law.

30. Mr. MOELLER (Observer for Finland) said that his delegation had difficulty in supporting the proposal because of the conflict the new rule might raise with article 28 and the question whether or not it would be mandatory.

31. Mrs. DASCALOPOULOU-LIVADA (Observer for Greece) said that her delegation approved the inclusion of the proposed rule. She did not see how it could fail to apply whether the parties wished it or not, since any agreement to proceed otherwise would be contrary to the provisions of the new article 18 *bis*, which dealt with equality of treatment.

32. The CHAIRMAN suggested that the Commission's report should show that the Commission had agreed that the rule on burden of proof in article 24 (1) of the UNCITRAL Arbitration Rules should usually be applied; and that it had decided not to include the rule in the text of the Model Law for three reasons: first, in some legal systems, the burden of proof was a matter of substantive and not procedural law; second, article 19 of the Model Law gave some latitude to the arbitral tribunal on the subject; third, whereas the UNCITRAL Arbitration Rules were applicable by the agreement of parties, the provisions in the Model Law would be mandatory. If he saw no objection, he would take it that the Commission accepted his suggestion.

33. *It was so agreed.*

Admissibility of written evidence

34. Mr. HOLTZMANN (United States of America) proposed the inclusion in the Model Law of article 25 (5) of the UNCITRAL Arbitration Rules, a provision which authorized the evidence of witnesses to be presented in the form of written statements signed by them. While he recognized that there was no requirement that the Model Law and the UNCITRAL Arbitration Rules should be identical, the Commission had nevertheless recommended to the Working Group on International Contract Practices that there should be consistency between them. He was aware that some legal systems regulated the admissibility of written evidence and also that the second sentence of article 19 (2) of the Model Law implicitly gave the arbitral tribunal the power to accept written statements if it so decided. However, in view of provisions in certain national legal systems, it would be helpful for the Model Law to make that point explicitly. Governments adopting it would thus accede to what was an established procedure in modern arbitration and one which, as experience had shown, had significantly reduced the costs of arbitral proceedings.

35. The CHAIRMAN said that the acceptance of article 19 would already be a considerable step forward for legal systems in which written statements were never admitted in evidence. It would be difficult for legislators to introduce a law which expressly allowed arbitrators to receive written evidence if that form was forbidden to judges.

36. Mr. HOLTZMANN (United States of America) said that, in view of the Chairman's comments, he withdrew his proposal.

37. The CHAIRMAN suggested that the report should state that the matter was covered by article 19 (2).

38. *It was so agreed.*

Requirement of reciprocity as a condition for recognition or enforcement

39. Mr. LEBEDEV (Union of Soviet Socialist Republics) drew attention to the written proposals of several Governments (A/CN.9/263, p. 51, paras. 9-13) that there should be a possibility for States to require reciprocity for recognition or enforcement of foreign awards. It might be appropriate to provide for that in article 35. Article 1 (3) of the 1958 New York Convention made provision for such a possibility, and a number of countries had availed themselves of it. The adoption of the Model Law by countries might turn upon whether they would want to enter a reservation on the matter of reciprocity. It was therefore essential to state in the Model Law that such a possibility existed.

40. The CHAIRMAN said he felt it would be inappropriate to introduce into a Model Law a provision which more naturally belonged in a convention. When adopting the Model Law, States could modify its provisions. He thought that a statement might appear in the report to the effect that the situation with regard to a requirement for reciprocity would be similar to that under the 1958 New York Convention.

41. Mr. LEBEDEV (Union of Soviet Socialist Republics) thought that something more was required than a statement in the report. It would be possible to provide for the matter in the Model Law in one of two ways: either by inserting in article 35 a reference to reciprocity together with a footnote

stating that its inclusion or non-inclusion in the legislation would be determined by each State when adopting the Model Law; or, alternatively, by providing a footnote to the effect that each State in adopting the Model Law might consider the inclusion in the legislation of the requirement of reciprocity.

42. Mr. RUZICKA (Czechoslovakia) associated himself with the views of the Soviet Union representative.

43. Mr. HOELLERLING (United States of America) said that his delegation also supported the principle of reciprocity, as it had stated in its written comment on the subject (A/CN.9/263, p. 51, para. 13). However, he thought it would be sufficient to have a statement on the matter in the report.

44. Mr. RAMADAN (Egypt) said that no footnote should appear in the Model Law. His country had ratified the 1958 New York Convention without entering any reservations, and article 1 (3) of that Convention made the principle of reciprocity optional. When the Commission had discussed article 35, the argument had been that it was desirable to keep it in harmony with the New York Convention.

45. Mr. ROEHRICH (France) said that he had no objection to allowing for the requirement of reciprocity but it would be necessary to define its exact scope more precisely. Would the requirement be satisfied by the enactment of identical provisions by another country or was something more involved? He felt that the subject could more readily be dealt with by means of a discussion at some length in the report rather than a brief footnote in the text.

46. Mr. VOIKEN (Observer for Switzerland) said the hope was that at some future date the principles of arbitral procedural law in many countries would be, if not identical, considerably harmonized by the influence of the Model Law. If that result was achieved, it would not greatly matter in which country proceedings were held. In the context of the legislative work on which the Commission was engaged, the concept of reciprocity, whether factual or legislative, was difficult to accommodate—in fact it almost ran counter to the

present work of the Commission. If it was to be mentioned, it should not be given too much importance.

47. The CHAIRMAN said the weight of opinion seemed to favour clarification of the matter in the report. The wording of article 35 did not imply that all States adopting the Model Law should necessarily extend the benefits of that article to all foreign awards indiscriminately. A State could limit the application of article 35 by the requirement of reciprocity to awards from countries where its own awards would be enforced in the same way and under the same conditions. The comments on the subject in the report should be placed in a prominent position at the beginning of the section on article 35. If he saw no objection, he would take it that the Commission accepted his suggestion.

48. *It was so agreed.*

Possibility of a preamble to the Model Law

49. Mr. TANG Houzhi (China) said that no decision had been taken as to whether the Model Law required a preamble.

50. The CHAIRMAN said that he thought there should be no preamble, as the Model Law would not be an international instrument.

51. *It was so agreed.*

52. The CHAIRMAN said that if he saw no objection, he would take it that the Commission had agreed on the contents of the Model Law and that no substantive issues would be reopened. The Commission would merely review the text from the drafting group to ensure that they faithfully reflected the decisions taken by the Commission and that they were satisfactory from the linguistic viewpoint.

53. *It was so decided.*

The discussion covered in the summary record ended at 3.35 p.m.

332nd Meeting

Thursday, 20 June 1985, at 3 p.m.

Chairman: Mr. LOEWE (Austria)

The meeting was called to order at 3.15 p.m.

International commercial arbitration (continued)

(A/CN.9/246, annex; A/CN.9/263 and Add.1-2, A/CN.9/264; A/CN.9/XVIII/CRP.14 and Add.1)

Draft text of a model law on international commercial arbitration

Articles 1 to 18 (A/CN.9/XVIII/CRP.14)

Article 1

1. *Article 1 was adopted without change.*

Article 2

2. Mr. HOLTZMANN (United States of America) said that, pursuant to the Commission's decision at the previous

meeting to include in the Model Law an express reference to counter-claims and defences to counter-claims (A/CN.9/SR.331, para. 14), his delegation and the delegation of Czechoslovakia had prepared a written proposal for the incorporation of a provision on the matter in article 2. The proposal would be submitted to the Commission for consideration.

3. The CHAIRMAN suggested that the Commission should adopt the article as worded by the drafting group, subject to consideration of that proposal.

4. *It was so decided.*

Articles 3 to 5

5. *Articles 3 to 5 were adopted without change.*

Article 6

6. Mr. GRIFFITH (Australia) said that article 16 (3) as proposed by the drafting group included a reference to the court or other authority specified in article 6 and should therefore be added to the list of provisions given.

7. Mr. HERRMANN (International Trade Law Branch) observed that the court functions referred to in articles 16 (3) and 34 (2) could, in fact, only be performed by a court and not by another authority.

8. The CHAIRMAN asked the Commission whether it considered that to be the case.

9. Mr. ROEHRICH (France) said that those delegations which had wished to include in the article a reference to an authority other than a court had had in mind articles 11 (3), 11 (4), 13 (3) and 14 only.

10. Mr. LEBEDEV (Union of Soviet Socialist Republics) proposed that the words "the court, courts or other authority" should be amended to read "the court, courts or, where so indicated herein, another authority".

11. Mr. HOLTZMANN (United States of America) said that his delegation could accept the Soviet Union's proposal but would suggest rewording it to read "... or, where referred to therein, ...".

12. Mr. GRIFFITH (Australia) proposed that the first comma in article 6 should be replaced by the word "and".

13. The CHAIRMAN said that, if there were no objections, he would take it that the Commission wished to replace the first comma in article 6 by the word "and" and to amend the words "the court, courts or other authority" to read "the court, courts or, where referred to therein, another authority".

14. *It was so decided.*

15. *Article 6, as amended, was adopted.*

Article 7

16. Mr. BOGGIANO (Observer for Argentina) said that in the second sentence of the Spanish version of paragraph (2), the word "*combatida*" should be replaced by the word "*negada*".

17. Mr. GRIFFITH (Australia) said that the word "another" at the end of the second sentence of the English version of paragraph (2) suggested that the text provided for the existence of more than two parties; that was not so with the French version, however, which used the words "*l'autre*".

18. Mr. HOLTZMANN (United States of America) said that the drafting group had intended to allow for the involvement of a third party. For the sake of clarity, the English version should be amended to read "another party".

19. The CHAIRMAN said that the Model Law had been conceived on the basis of the involvement of two parties.

20. Mr. RICKFORD (United Kingdom) suggested that the text should be amended to read "the other or others" in order to provide for the possibility that more than two parties would be involved.

21. Mr. ROEHRICH (France) said that the French version correctly reflected what the Chairman had said. He noted that other articles spoke of "a party" or "the other party". It would be unwise for the Commission to enter into the complex area of multiparty arbitration. In any case, the present text did not exclude the possibility of there being several parties on one side and several on the other.

22. The CHAIRMAN said that there did not seem to be any difference of opinion as to the substance of the provision, and he therefore suggested that the text should remain unchanged.

23. *Article 7 was adopted without change, subject to the correction in the Spanish version requested by the Observer for Argentina.*

Article 8

24. Mr. SAMI (Iraq) said that the Arabic version of paragraph (2) was incorrect and should be brought into line with the English version.

25. Mr. SEKHON (India) said that the words "and an award may be made" in paragraph (2) were superfluous, since they were implied by the phrase "arbitral proceedings may nevertheless be commenced or continued".

26. The CHAIRMAN said that the words had been included in order to make it clear that the arbitrators need not stop short of making an award.

27. *Article 8 was adopted without change, subject to the correction in the Arabic version requested by the representative of Iraq.*

Articles 9 and 10

28. *Articles 9 and 10 were adopted without change.*

Article 11

29. In reply to a question put by Mr. GRIFFITH (Australia), Mr. HERRMANN (International Trade Law Branch) said that the wording of paragraph (4) (c) correctly reflected the decision taken by the Commission at its 319th meeting (A/CN.9/SR.319, para. 67).

30. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that the Russian version of the draft text of the Model Law had been issued before the drafting group had completed its work and it did not reflect some of the provisions agreed by the group. That applied to paragraph (5) and to other parts of the draft text. He would be agreeable to the definitive Russian version of the text being prepared by the secretariat at a later stage. That being so, he would not raise points which affected the Russian version only.

31. *Article 11 was adopted without change.*

Article 12

32. Mr. SAMI (Iraq) pointed out that the reference to impartiality or independence had not been rendered correctly in the Arabic text.

33. *Article 12 was adopted without change, subject to the correction in the Arabic version requested by the representative of Iraq.*

Article 13

34. Mr. GRIFFITH (Australia) said that, in the light of the discussion of article 16 (3) at the 320th meeting, paragraph (2) should refer to a period of 30 days, as did paragraph (3).

35. The CHAIRMAN said that since paragraphs (2) and (3) dealt with different topics there was no need for them to specify the same period. He suggested that, since the Commission had not taken a clear decision to amend the period in paragraph (2), the text should remain unchanged.

36. Mr. SEKHON (India), referring to the words "and make an award" at the end of paragraph (3), drew the Commission's attention to the commentary on the point in its draft report (A/CN.9/XVIII/CRP.2/Add.5, para. 12). If the expression "the system" used in the draft report was meant to include the further steps, he would have no particular objection, but the present paragraph (3) had been drafted in a slightly different fashion.

37. Mr. HERRMANN (International Trade Law Branch) said that the point referred to by the representative of India concerned primarily the question of which of the four or five possible solutions was preferred with respect to determination of the time at which court control could be exercised. The question whether the continuation of the proceedings implied the making of an award had been referred to the drafting committee, which had decided that it would be better to state the provision clearly. That was why the express reference to the making of an award appeared in several places in the draft text.

38. *Article 13 was adopted without change.*

Articles 14 and 15

39. *Articles 14 and 15 were adopted without change.*

Article 16

40. Mr. SAMI (Iraq) said that paragraph (3) of the Arabic version still referred in brackets to alternative periods of 15 or 30 days. The reference to 15 days and the brackets should be deleted.

41. Mr. VOLKEN (Observer for Switzerland) noted that in the French version the word "*pouvoir*" in the heading of the article had been changed to "*compétence*". He thought that the word "*pouvoir*" should be retained; the drafting group had not altered it in the heading of article 18.

42. After a discussion in which the CHAIRMAN, Mr. ROEHRICH (France) and Mr. VOLKEN (Observer for Switzerland) took part, the CHAIRMAN asked if the French-speaking delegations would accept the present wording of the French version of the heading.

43. *It was so agreed.*

44. Mr. HERRMANN (International Trade Law Branch) suggested that the Commission, bearing in mind the discussion earlier in the meeting on article 6, might wish to delete the words "or other authority".

45. Mr. VOLKEN (Observer for Switzerland) said that if a State wished to appoint an authority other than a court to perform the function referred to in article 16 (3), it should not be prevented from doing so.

46. Mr. GRIFFITH (Australia) said that the words "or other authority" should be retained in order to ensure consistency with article 13 (3).

47. Mr. SEKHON (India) pointed out that, as indicated in the draft report (A/CN.9/XVIII/CRP.2/Add.9, para. 13), the Commission had decided to provide for instant court control in article 16 (3) along the lines of the solution adopted in article 13 (3).

48. Mr. LEBEDEV (Union of Soviet Socialist Republics) suggested that the words "court or other authority specified in article 6" should be amended to read "competent court".

49. Mr. SAMI (Iraq) said that the functions referred to in article 16 (3) could only be performed by a court. An explanatory note to article 16 (3) might be provided to that effect.

50. The CHAIRMAN said that, if there were no objections, he would take it that the Commission wished to delete the words "or other authority".

51. *It was so decided.*

52. *Article 16, as amended, was adopted, subject to the correction in the Arabic version requested by the representative of Iraq.*

Article 18

53. Mr. VOLKEN (Observer for Switzerland) proposed that the words "order any party to take such interim measure" should be amended to read "order such interim measure".

54. The CHAIRMAN said that the change did not seem essential. He invited the Commission to adopt article 18.

55. *Article 18 was adopted without change and renumbered as article 17.*

*Articles 18 bis to 36 (A/CN.9/XVIII/CRP.14/Add.1)**Article 18 bis*

56. *Article 18 bis was adopted without change and renumbered as article 18.*

Articles 19 to 23

57. *Articles 19 to 23 were adopted without change.*

Article 24

58. Mr. ROEHRICH (France) said that a problem had arisen in the drafting group in regard to the second sentence of paragraph (1). The question was whether the words "at an appropriate stage of the proceedings", which had been between commas in the original version of the paragraph, applied to a party's request for oral hearings or to the arbitral tribunal's decision to hold such hearings: in other words, whether they imposed a restriction on the parties or whether they gave discretion to the arbitral tribunal. If they were interpreted in the former sense, it would modify the Commission's decision that the parties had a fundamental right to request an oral hearing.

59. The CHAIRMAN said that, as he saw it, the paragraph could mean only that the party must make the request at an appropriate stage of the proceedings, otherwise it would make

no sense. The meaning was perhaps clear in the English version.

60. Mr. SZASZ (Hungary) said that his understanding of the discussion was that the words "if so requested by a party at an appropriate stage of the proceedings" meant that a party could at any time ask for oral proceedings and the tribunal could note the request and could act accordingly but would not be compelled to hold an oral hearing forthwith.

61. Mr. HOLTZMANN (United States of America) said that the discussion had arisen out of his Government's written proposal (A/CN.9/263, p. 35, para. 1) for a new paragraph (1) to replace the former paragraphs (1) and (2) of the Working Group's draft, and stating: "if either party so requests at an appropriate stage of the proceedings . . .". It had been his understanding that the Commission had approved his proposal.

62. Mr. HERRMANN (International Trade Law Branch) said that it had been the secretariat's understanding that the United States proposal had been accepted as a drafting suggestion and that no decision had been taken on the question whether "appropriate" should qualify the parties' request or the holding of a hearing.

63. Mr. SZASZ (Hungary), speaking as Vice-Chairman, said he had been in the Chair at the time of the discussion. He agreed with what the representative of the Secretariat had just said. It was his understanding that the article had been sent to the drafting group without any substantive change from what had been expressed in the original draft.

64. Mr. de HOYOS GUTIERREZ (Cuba) said that it was clear from the paragraph as at present drafted that the arbitral tribunal should hold hearings if the parties so requested at an appropriate stage in the proceedings.

65. The CHAIRMAN suggested that the matter might be resolved by wording the sentence to read "... the arbitral tribunal shall hold such hearings at an appropriate stage of the proceedings if so requested by a party".

66. Mr. RICKFORD (United Kingdom) and Mr. ROEHRICH (France) supported the Chairman's suggestion.

67. Mr. HOLTZMANN (United States of America) said that he would accept the Chairman's suggestion on the understanding that it was made clear in the record that an arbitral tribunal could refuse a last-minute request for a hearing, on the ground that there was no longer any appropriate stage of the proceedings for a hearing. He gave as an example a last-minute request that had been submitted solely for the purpose of delaying the issue of the award where no acceptable reasons had been given to justify holding a hearing.

68. Mr. LAVINA (Philippines) supported the Chairman's proposal.

69. Mr. SAMI (Iraq) said that the tribunal should not have the right to oppose a request: the parties' right to request oral hearings must be safeguarded.

70. Mr. MTANGO (United Republic of Tanzania) agreed.

71. In reply to a question put by the Chairman, Mr. SZASZ (Hungary), speaking as Vice-Chairman, said that his notes and the summary record of the 324th meeting (A/CN.9/SR.324) both confirmed the following: that, after a lengthy discussion touching on points both of substance and of drafting, it had been agreed to consider the substantive points

referred to in para. 1 of that summary record. No other point had been considered as a point of substance in the discussion, and no speaker had asked for a ruling on any question other than those submitted to the drafting group.

72. After a discussion in which Mr. HOLTZMANN (United States of America), Mr. RICKFORD (United Kingdom) and Mr. ROEHRICH (France) took part, the CHAIRMAN said that the issue seemed to be one on which there had been a misunderstanding about what the Commission had decided. Since the evidence suggested that the Commission had intended that the paragraph should provide that a party could make a request at any time and that the tribunal must hold hearings, and also that the reference to the appropriate stage should be retained, he asked the Commission if it would accept his earlier suggestion.

73. *It was so agreed.*

74. Mr. GRIFFITH (Australia) proposed that the commas in the third and fourth lines of paragraph (3) should be deleted.

75. *It was so agreed.*

76. *Article 24, as amended, was adopted.*

Article 25

77. Mr. GRIFFITH (Australia) said that the phrase "without showing sufficient cause" in the opening portion only applied to subparagraph (a) and should therefore be included in that subparagraph. It had no application to subparagraphs (b) and (c).

78. The CHAIRMAN said that the matter had not been discussed by the Commission. He could not reopen discussion of the article unless the Commission wished it.

79. *Article 25 was adopted without change.*

Article 26

80. *Article 26 was adopted without change.*

Article 27

81. Mr. GRIFFITH (Australia) asked for clarification as to whether, as a result of the redrafting of the article, the "competent court" which it mentioned was the court specified in article 6.

82. The CHAIRMAN said that the "competent court" to which article 27 referred was not the court specified in article 6. It was a court which might be requested to take evidence from a witness who, for example, was unable to appear before the tribunal because he lived at too great a distance.

83. Mr. MATHANJUKI (Kenya) asked the Chairman to confirm that article 27 did not cover the question of the procedure for implementing the request.

84. The CHAIRMAN confirmed that.

85. *Article 27 was adopted without change.*

The meeting rose at 6.05 p.m.

333rd Meeting

Friday, 21 June 1985, at 10 a.m.

Chairman: Mr. LOEWE (Austria)

The discussion covered in the summary record began at 10.40 a.m.

International commercial arbitration (*continued*)
(A/CN.9/246, annex; A/CN.9/263 and Add. 1-2, A/CN.9/264;
A/CN.9/XVIII/CRP.14 and Add. 1)

*Draft text of a model law on international commercial
arbitration*

Article 2 and articles 28-36

Article 2

1. Mr. RICKFORD (United Kingdom) raised the question of interconnection between chapter VI of the Model Law and the version of article 2 (*d*) which the Commission had adopted at its previous meeting. In order to take account of a particular concern in relation to article 28 (1), article 2 (*d*) had been amended so that it did not apply to any of chapter VI, which contained, however, a series of references to agreement between the parties and the choice of parties. Perhaps the Commission had made the wrong amendment to article 2 (*d*).

2. Mr. HERRMANN (International Trade Law Branch) said that the amendment had been made because concern had been expressed that it was inappropriate to recognize the freedom of the parties to authorize third parties or institutions to make decisions as to the law applicable to disputes. Perhaps the amendment had gone too far. He suggested that a more appropriate wording for the opening phrase of article 2 (*d*) would be: "where a provision of this Law, except article 28, leaves the parties . . ."

3. Mr. GRIFFITH (Australia) supported the Secretariat proposal.

4. The CHAIRMAN said that, if he saw no objection, he would take it that the Commission wished to amend the text of article 2 (*d*) in the manner just proposed by the secretariat.

5. *It was so decided.*

Article 28

6. Mr. GRIFFITH (Australia) said that the Commission had decided to include in article 28 a provision modelled on article 33 (3) of the UNCITRAL Arbitration Rules, (A/CN.9/XVIII/CRP.2/Add.15, paragraph 11). However, the text of that rule had been reproduced in article 28, paragraph (4). As a result, the word "contract" had been used for the first time in the Model Law. In conformity with the general approach in that document, he thought that an expression such as "agreement between the parties" would be more appropriate.

7. Mr. HERRMANN (International Trade Law Branch) said that article 28 (4) was not the first time that the word "contract" had been used. It appeared in article 16 (1). The expression "agreement between the parties" was frequently used in the Model Law in connection with the arbitration agreement and not with the main contract on substance. It would therefore not be an appropriate substitute for the word "contract".

8. Mr. GRIFFITH (Australia) withdrew his proposal.

9. *Article 28 was adopted.*

Article 29

10. *Article 29 was adopted.*

Article 30 (1) and (2)

11. Mr. SEKHON (India) recalled that his delegation had suggested that, in article 30 (1), "record the settlement in the form of an arbitral award on agreed terms" be replaced by "record the settlement and make the award on agreed terms" and that, in article 30 (2), "and shall state that it is an award" be deleted.

12. Mr. HERRMANN (International Trade Law Branch) said that the proposal had been referred to the drafting group, which had decided to retain the wording set out in the text.

13. The CHAIRMAN said that, if he heard no objection, he would take it that the Commission wished to retain the text of article 30 unaltered.

14. *It was so agreed.*

15. *Article 30 was adopted.*

Articles 31 and 32

16. *Articles 31 and 32 were adopted.*

Article 33 (1)

17. Mr. LAVINA (Philippines) said that the wording of article 33 (1) (*b*) was somewhat clumsy: "if so agreed by the parties, a party, with notice to the other party," should be replaced by "a party, with the agreement of the other party".

18. The CHAIRMAN recalled that in its discussion of the subparagraph, the Commission had agreed that the other party must be assured of an opportunity to give its opinion. Although the wording was less than elegant, it was the best way that had been found of making the point absolutely clear. If he heard no objection, therefore, he would take it that the Commission wished to adopt article 33 (1) unaltered.

19. *Article 33 (1) was adopted.*

Article 33 (2)

20. *Article 33 (2) was adopted.*

Article 33 (3)

21. Mr. GRIFFITH (Australia) proposed that the final sentence of article 33 (3) be amended to conform to the

wording of the penultimate sentence of article 33 (1), i.e. to read: "If the arbitral tribunal considers the request to be justified, it shall make the additional award within 60 days."

22. *It was so agreed.*

23. *Article 33 (3), as amended, was adopted.*

Article 33 (4) and (5)

24. *Article 33 (4) and Article 33 (5) were adopted.*

25. *Article 33 as a whole, as amended, was adopted.*

Article 34 (1)

26. *Article 34 (1) was adopted.*

Article 34 (2)

27. The CHAIRMAN said that "Court" should be replaced by "court".

28. Mr. GRIFFITH (Australia) noted that "arbitrator(s)" was the term used in article 36 (1) (a) (ii) and asked whether the same term should not be incorporated in article 34 (2) (a) (ii).

29. Mr. HERRMANN (International Trade Law Branch) suggested that conformity might better be achieved by amending article 36 (2) (a) (ii) than by amending article 34 (2) (a) (ii). The important principle involved was that the parties should be notified of the appointment of *each* of the arbitrators. Although "the arbitrator" was the term in the 1958 New York Convention, it would be better to use different wording in order to make the point absolutely clear.

30. Mr. ROEHRICH (France) supported the comments made by the representative of the secretariat.

31. *Article 34 (2) was adopted.*

Article 34 (3) and (4)

32. *Article 34 (3) and article 34 (4) were adopted.*

33. *Article 34 as a whole was adopted, subject to the minor drafting change mentioned by the Chairman.*

Article 35

34. *Article 35 was adopted.*

Article 36

35. Mr. SAMI (Iraq) suggested an amendment to the Arabic version of article 36 (1) (a) (i).

36. The CHAIRMAN said that it would be taken into account by the secretariat.

37. Mr. GRIFFITH (Australia) said he assumed that, in article 36 (1) (a) (ii), "the arbitrator(s)" was to be amended to read "an arbitrator".

38. The CHAIRMAN said that that was correct.

39. *Article 36 (1), as amended, was adopted.*

Article 36 (2)

40. *Article 36 (2) was adopted.*

41. *Article 36 as a whole, as amended, was adopted.*

Proposal for a new provision on counter-claims

42. The CHAIRMAN recalled that the representatives of the United States and Czechoslovakia had drafted a new provision for article 2, which would become article 2 (f) and which was contained in document A/CN.9/XVIII/CRP.15.

43. Mr. de HOYOS GUTIERREZ (Cuba) suggested a drafting change in the Spanish version.

44. Mr. ROEHRICH (France) suggested a drafting change in the French version.

45. Mr. LAVINA (Philippines) pointed out a typographical error: "article" should be amended to read "articles".

46. The CHAIRMAN said that the secretariat would take those comments into account.

47. Mr. SAWADA (Japan) said that his delegation did not oppose the inclusion of a provision on counter-claims but felt that such a provision should contain a more exhaustive definition of counter-claims than did the proposal before the Commission.

48. The CHAIRMAN said that, in its decision to include a provision on counter-claims, the Commission had recognized that it was necessary to be brief and to indicate merely which rules should apply to counter-claims.

49. Mr. VOLKEN (Observer for Switzerland) suggested that, since the proposed provision was not a definition but rather an extension of the scope of the Model Law, it should be included in article 1 rather than in article 2.

50. The CHAIRMAN pointed out that the heading of article 2 was not simply "Definitions" but "Definitions and rules of interpretation" and that the provision in question was in fact a rule of interpretation.

51. Mr. HOLTZMANN (United States of America) suggested that the provision be revised by the insertion, after "article", of "7 (2) and".

52. Mr. HERRMANN (International Trade Law Branch) said that he had doubts whether it was appropriate to mention article 7 (2) in that context.

53. Mr. HOLTZMANN (United States of America) said that his delegation would not insist on the revision.

54. Mr. RICKFORD (United Kingdom) said that the representative of the International Trade Law Branch had a good point, but that unless article 7 (2) was included among the list of exceptions to article 2 (f), an agreement made in respect of the subject-matter of a counter-claim could result in the closing of the entire dispute. Under English law, contracts would have to state expressly that article 2 (f) applied *mutatis mutandis*.

55. The CHAIRMAN said that, if he heard no objection, he would take it that the Commission wished to adopt the text of article 2 (j) contained in document A/CN.9/XVIII/CRP.15.

56. *It was so agreed.*

57. *The draft text of a model law on international commercial arbitration (A/CN.9/XVIII/CRP.14 and Add.1) as a whole, as amended, was adopted.*

58. Mr. SONO (Secretary of the Commission) suggested that the title of the text the Commission had just adopted should be the UNCITRAL Model Law on International Commercial Arbitration, that the Commission should request the Secretary-General to transmit the text, with its *travaux préparatoires*, to Governments, arbitration institutions and other interested bodies at the close of its eighteenth session, that it should invite the General Assembly to recommend to States that they consider using the Model Law when they revised their laws to meet the current needs of international commercial arbitration, and that the secretariat should send a *note verbale* to Governments informing them of that recommendation.

59. Mr. MTANGO (United Republic of Tanzania) asked whether the Model Law would be transmitted to States before or after the General Assembly had adopted it.

60. Mr. SONO (Secretary of the Commission) said that, when the UNCITRAL Arbitration Rules had been adopted, they had been transmitted to Governments immediately after their adoption but before endorsement by the General Assembly, and that the Model Law should be given the same treatment.

61. Mr. LEBEDEV (Union of Soviet Socialist Republics) said that the matter was a very important one as it would be included in the Commission's report to the Sixth Committee and the General Assembly. He suggested that the secretariat should produce a working paper on the subject in at least one of the working languages so that delegations could give it due consideration.

62. Mr. ROEHRICH (France) said that his delegation agreed with the Soviet Union representative. He suggested that the secretariat might transmit the Model Law to Governments as a working paper and indicate that it had been adopted by UNCITRAL and would be submitted to the next session of the General Assembly.

63. Mr. LAVINA (Philippines) said that he agreed with the view that the Commission should submit the Model Law to the General Assembly for adoption; however, if there was a precedent for not doing so, he could go along with the proposals made by the Secretary of the Commission.

64. The CHAIRMAN, referring to document A/CN.9/XVIII/CRP.2/Add.19, paragraphs 8 and 9, noted that the General Assembly would not be asked to adopt the Model Law but to make a recommendation that Member States use it. If he heard no objection, he would take it that the Commission wished to adopt the proposals made by the Secretary of the Commission.

65. *It was so agreed.*

The discussion covered in the summary record ended at 12 noon.

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IV. CHECK-LIST OF UNCITRAL DOCUMENTS

<i>Title or description</i>	<i>Document symbol</i>	<i>Location in present volume</i>
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1. General series		
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Report of the Working Group on International Contract Practices on the work of its eighth session (Vienna, 3-13 December 1984)	A/CN.9/260	Part two, IV, A
Report of the Working Group on International Negotiable Instruments on the work of its thirteenth session (New York, 7-18 January 1985)	A/CN.9/261	Part two, II, A
Report of the Working Group on the New International Economic Order on the work of its seventh session (New York, 8-19 April 1985)	A/CN.9/262	Part two, III, B, 1
Analytical compilation of comments by Governments and international organizations on the draft text of a model law on international commercial arbitration: report of the Secretary-General (The original French text of A/CN.9/263/Add.3 was unofficially made available during the session)	A/CN.9/263 and Add.1-3	Part two, I, A
Analytical commentary on draft text of a model law on international commercial arbitration: report of the Secretary-General	A/CN.9/264	Part two, I, B
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B. List of documents before the Working Group on International Negotiable Instruments at its thirteenth session

1. *Working papers*

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2. *Restricted series*

Draft report of the Working Group on International Negotiable Instruments on the work of its thirteenth session (New York, 7-18 January 1985)	A/CN.9/WG.IV/XIII/CRP.1 and Add.1-5	Not reproduced
Article 25, proposal by <i>ad hoc</i> Working Party	A/CN.9/WG.IV/XIII/CRP.2	Not reproduced
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Article 4, proposal by the Secretariat	A/CN.9/WG.IV/XIII/CRP.4	Not reproduced
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1. *Working papers*

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Draft legal guide on drawing up international contracts for construction of industrial works: draft chapters	A/CN.9/WG.V/WP.13/Add.1-6	Part two, III, A, 2

2. *Restricted series*

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