

needs of the Model Law for a rule on the effect of a completed credit transfer without raising the kinds of concerns that had been raised about the current text. The delegation of France has proposed a text which is set out at comment 11.

Paragraph (1)

3. Paragraph (1) deals with the important rule that monetary obligations can be discharged by interbank credit transfers leading to credit to an account. While this general proposition is widely recognized today, remnants of the objections arising out of legal tender legislation still arise on occasion. Furthermore, in some countries it is not clear that any person other than the account holder has the right to deposit funds to an account. As a result the Working Group agreed at its seventeenth session that it would be appropriate to include such a rule (A/CN.9/317, para. 158).

4. The Working Group agreed at its seventeenth session that paragraph (1) should be restricted to providing that an obligation could be discharged by a transfer without considering to what account the debtor-originator might have the funds sent (A/CN.9/317, para. 159). At the nineteenth session the question was raised as to whether the provision would limit the beneficiary's right to require payment to it in legal tender or to reject a specific payment made by means of a credit transfer (A/CN.9/328, para. 38). In reply it was pointed out that some States had tax laws that required commercial payments to be made by cheque, credit transfer or other similar means, while many other States had statutory provisions similar to paragraph (1) (A/CN.9/328, para. 40). At the twentieth session the general view was that paragraph (1) should be deleted because it attempted to state a rule that might be generally followed in practice, but that violated deeply held feelings about the appropriate legal rules on the subject (A/CN.9/329, para. 190). However, since it had been decided that the discussion was to be only for the purpose of laying a foundation for a more thorough discussion at the twenty-first session, no action was taken.

Paragraph (2)

5. Paragraph (2) provides that the obligation of the debtor is discharged when the beneficiary's bank accepts the payment order. At the same time the beneficiary's bank becomes indebted to the beneficiary.

6. In the seventeenth session of the Working Group it was pointed out that in some countries an obligation was considered to be discharged when the originator's bank received the payment order with cover from the debtor-originator. It was thought that other countries might provide that the discharge would be later in time than as provided in paragraph (2). Therefore, the Working Group decided to consider at a future session what effect such national laws on discharge of the underlying obligation should have on the appropriate rules on finality of the credit transfer, keeping in mind its position that the rules on discharge, whether under the Model Law or under national law, and the rules governing finality should be

consistent (A/CN.9/317, paras. 160-162). At the nineteenth session the desirability of having the beneficiary's bank become indebted to the beneficiary at the same time any obligation of the originator was discharged was restated (A/CN.9/328, para. 41).

7. Nevertheless, at the nineteenth session of the Working Group the text of paragraph (2) was said to raise problems. Although some obligations could be partially discharged by payment of a part of the money due, other obligations were indivisible. Furthermore, the law governing the means by which and the extent to which an obligation could be discharged might be that of a State in which neither the originator's bank nor the beneficiary's bank was located (A/CN.9/328, para. 39). In reply it was suggested that the provision on discharge might indicate that the obligation would be discharged to the extent that payment of the same amount of money would discharge the obligation, thereby taking no position as to whether an obligation could be partially discharged (A/CN.9/328, para. 42).

8. In the working paper submitted to the twentieth session the Secretariat suggested two possible reformulations of paragraph (2), one of which provided a specific rule on discharge and the other of which stated only when the transfer was completed (A/CN.9/WG.IV/WP.44, article 14, comments 7 and 8). The second approach would leave to other rules of law any conclusions as to the effect on the discharge of the obligation, if the transfer was for the purpose of discharging an obligation.

9. At the twentieth session both proposals received some support, but the view was also expressed that the first one would be unacceptable in some States as a matter of legislative policy because of the very fact that it set out a rule for the discharge of obligations (A/CN.9/329, para. 191). In a communication to the Secretariat the delegation of France raised additional objections, i.e., that a rule on discharge is applicable only if the transfer is for the purpose of discharging an obligation and not, for example, a cash consolidation operation; a rule on discharge should be subject to the parties agreement specifying a different means of discharge of the obligation or transfer to a different account than the one to which the transfer was made; the methods of discharge of an underlying obligation are already exhaustively specified by law in some legal systems and the proposed rule on discharge would change the law of contract, even though that should be beyond the scope of the Model Law.

10. As a result of these objections raised to the inclusion in the Model Law of any rule on discharge of an obligation by funds transfer, only the second of the two Secretariat proposals submitted to the twentieth session is repeated here:

"The beneficiary's bank becomes indebted to the beneficiary and the transfer of funds from the originator to the beneficiary is completed when the beneficiary's bank accepts a payment order ordering payment to the beneficiary."

11. In the communication to the Secretariat referred to in comment 9 the delegation of France proposed a

different formulation for what is presently paragraph (2). In the French proposal paragraphs (1), (3) and (4) as well as the third sentence of article 2(a) would be deleted. The French proposal is as follows:

"Unless otherwise agreed by the sender and the beneficiary, a transfer is completed when the beneficiary's bank places the funds at the beneficiary's disposal or notifies him that it is holding the funds for his benefit, in accordance with article 8(1) or (6)."

Paragraph (3)

12. Paragraph (3) is concerned with a difficult problem when credit transfers pass through several banks. The originator is responsible for all charges up to the beneficiary's bank. So long as those charges are passed back to the originator, there are no difficulties. When this is not easily done, a bank may deduct its charges from the amount of the funds transferred. Since it may be impossible for an originator to know whether such charges will be deducted or how much they may be, especially in an international credit transfer, it cannot provide for that eventuality. Therefore, paragraph (3) provides that the obligation is discharged by the amount of the charges that have been deducted as well as by the amount received by the beneficiary's bank; the originator would not be in breach of contract for late or inadequate payment. Nevertheless, unless the beneficiary agrees to pay the charges, which often occurs, the originator would be obligated to reimburse the beneficiary for them.

13. In a communication to the Secretariat the delegation of the United Kingdom suggested that paragraph (3) did not seem to be sensible either commercially or as a matter of legal principle. It said that the statement that the beneficiary may then recover the shortfall from the sender is likely merely to lead to a further credit transfer and more confusion. The delegation of the United Kingdom, as well as the delegation of France in a separate communication, recommended the deletion of the paragraph. See also article 4, comment 19, above, for the converse question as to whether the sender should be responsible to pay for the costs and charges.

Paragraph (4)

14. Paragraph (4) is the corollary to paragraph (2) in that it provides the rule as to when the account of a sender, including but not limited to the originator, is to be considered debited, and the amount owed by the bank to the sender reduced or the amount owed by the sender to the bank increased. That point of time is when the receiving bank accepts the payment order which, in the usual situation for a receiving bank that is not the beneficiary's bank, is when it executes the payment order by sending a new payment order to the next bank. It may be before or after the bookkeeping operation of debiting the account is accomplished. Paragraph (4) may have its most important application in determining whether credit is still available in the account holder's account if legal process has been instituted against the account or insolvency proceedings have been instituted against the sender. This paragraph should be considered in the light of article 4(4) (see article 4, comment 20, above).

15. At the twentieth session it was suggested that paragraph (4) was not entirely consistent with article 4(4) since article 14(4) spoke of the acceptance of the payment order by the receiving bank (A/CN.9/329, para. 110). In a communication to the Secretariat the delegation of the United Kingdom made essentially the same point that the two were inconsistent, but stated that it was because payment under article 4(4) was not due until execution. It suggested that if that objection was overcome, and if it was felt by the Working Group that a statement about when a sender's account should be deemed to have been debited was needed (for example for the reasons given above), the provision should be adapted and incorporated in article 4(4). In a separate communication to the Secretariat the delegation of France recommended the deletion of paragraph (4).

CHAPTER V. CONFLICT OF LAWS

Article 15. Conflict of laws

(1) Persons who anticipate that they will send and receive payment orders may agree that the law of the State of the sender, of the receiver or of the State in whose currency the payment orders are denominated will govern their mutual rights and obligations arising out of the payment orders. In the absence of agreement, the law of the State of the receiving bank will govern the rights and obligations arising out of the payment order.

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

Prior discussion

A/CN.9/297, paras. 34 to 36

A/CN.9/317, para. 165

A/CN.9/WG.IV/WP.42, paras. 69 to 80

Comments

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

2. The problem of conflict of laws is considered in more detail in the report of the Secretary-General to the nineteenth session of the Working Group, A/CN.9/WG.IV/WP.42, paras. 69 to 80. That report considers the issues especially in light of the decisions of the Working Group

at its eighteenth session that the text under preparation should be in the form of a model law for adoption by national legislative bodies and that it should be restricted to international credit transfers.

3. The report states that the Model Law might include a provision on its territorial application and that, in addition, consideration might be given to a provision governing the conflict of laws where the dispute arises in a State that has adopted the Model Law but the other State or States concerned have not, or where the text of the Model Law does not govern the issue at hand (paragraph 71). The report concludes that in general the law applicable to any given segment of the credit transfer should be the law of the receiving bank, but goes on to give illustrations from the text of the draft Model Law as it was before the eighteenth session of cases in which the law of a different State might be appropriate (paragraphs 75 to 77). While the text of the draft Model Law has changed substantially in presentation since that time, the conclusions as to the appropriate law to be applied to the different problems would seem to remain valid.

4. In a communication to the Secretariat the delegation of the United Kingdom suggested that paragraph (1) be amended to add the words "or of the State in which the place of sending or receipt is situated" after "denominated" and the words "law of the State where the payment order is received" be substituted for "the law of the State of the receiving bank" in the penultimate line.

5. If the Working Group was to decide to redraft article 14(2) so as to delete any rule on discharge of an obligation (see article 14, comments 7 to 11), it would seem to be clear that article 15(2) would be deleted from the Model Law.

[A/CN.9/WG.IV/WP.46/Corr.1]

Article 2

Paragraph numbers 8 and 9 of the comments are missing due to an error in numbering and no substance was omitted.

2. International credit transfers: proposal of the United States of America: note by the Secretariat (A/CN.9/WG.IV/WP.47) [Original: English]

INTERNATIONAL CREDIT TRANSFERS

Proposal of the United States of America Note by the Secretariat

1. At the twentieth session of the Working Group the delegation of the United States suggested the possibility of restructuring the Model Law into two parts: one applicable to high-speed systems and another applicable to slower systems (A/CN.9/329, para. 197). The delegation has now submitted its proposal as to how such a restructuring might be accomplished.

2. This note contains in the annex the covering letter from the United States delegation plus its proposal with explanatory comments.

ANNEX

Covering letter from the United States, dated 6 June 1990

We have enclosed several proposed modifications to the draft Model Law for international credit transfers being prepared by the Working Group on International Payments.

Together with many other delegations, we have seen the preparation of this Model Law as an important opportunity for UNCITRAL to be among the first international bodies to achieve harmonization in international trade law in the new field of electronic commerce. A project of this nature is of course difficult, since it must deal with the conflict between newly emerging commercial practices and traditional laws and obligations.

At the conclusion of the last Working Group session on this subject, which took place in Vienna, 27 November-8 December 1989, the US delegation expressed serious concern as to the direction the draft Model Law was taking, and whether as then drafted it was compatible with new electronic banking and clearing systems. We believe that any proposed international

rules must recognize high-speed systems and the changed legal relationships that result. Otherwise, the rules if adopted would have the effect of impeding new commercial methods, rather than facilitating world trade. In the latter case, such rules may be unlikely to achieve widespread acceptance by States, and UNCITRAL would have lost an opportunity to be a leader in setting norms for modern electronic commerce.

Bank credit transfers, which are an important part of the new electronic commerce, can play a role in expanding services and lowering costs for commercial parties in all nations, regardless of their state of economic development or particular trade interest. With respect to commercial users, as distinct from consumers, modern electronic transfers today offer the option of high-speed, low cost transactions. Such transactions may depend on electronic clearing houses which, through computer-assisted high-speed systems, are able to handle very large volumes of transactions daily. At the same time, these computer-assisted systems, because of their very high volume, operate on a "best-efforts" basis and cannot undertake the same obligations that may accompany traditional funds transfers.

The latter may involve conditional payments, bank verification of transactions, reversibility, indeed many other facets may involve direct intervention by bank personnel. Commercial customers are likely to want the option of using either more traditional transfer methods, which may also use electronic means but would involve a wider range of responsibilities by banks and involve higher costs, or the newer high-speed systems at low cost. In the latter case, customers are likely to absorb certain risks in order to use those services; for example, computer-assisted systems at high speed and volume cannot normally accommodate reversal and do not allow for individual transaction monitoring and consequent exposure to responsibilities for errors or failures in the same manner as do traditional credit transfer methods. The sheer volume of transactions places real burdens on banks and clearing houses with respect to notice obligations and liability for damages, which must be taken into account if any proposed rules are to be compatible with the newly emerging electronic clearing systems.

At the conclusion of the last Working Group session, the US delegation suggested that the Working Group might wish to consider preparing two sets of rules, rather than one, in order to separate the rights and obligations of parties to banking transactions into two options—the first dealing with emerging practices in high-speed electronic transfers, and the second covering traditional transactions, which could accommodate paper-based as well as more rapid methods of transacting commerce. In the latter, originators would expect a broader range of responsibilities in return for greater cost and less speed.

There are several ways to achieve this “two-track” system. We have attached one proposal that would accomplish this by assuring through choice of law and conflict of law provisions the right of parties to engage in transactions under rules developed for electronic commerce. Such an approach could leave in place the present draft as modified by further work of the Working Group and the Commission. At the same time, it would allow for application of rules designed for high-speed transfers and therefore assure the relevance of the Model Law to commerce as it is likely to be practised by an increasing number of commercial parties and States. A separate method would be to draft two sets of rules by declaring certain provisions of the present draft inapplicable to high-speed transactions, as defined, and by writing new rules to cover those transactions.

These suggestions are being made in order to facilitate the discussion of the Working Group. We remain committed to the importance of the Commission finishing its work on this subject as early as possible.

Proposal by the United States delegation to amend the draft Model Law on International Credit Transfers to accommodate high-speed electronic transfers

At the twentieth session of the Working Group on International Payments, the US delegation expressed its concern that the text of the draft Model Law would not be suitable for credit transfers made over systems that have been designed to accomplish a transfer with high speed, maximum security, and low cost. Accordingly, the US delegation suggests that the Model Law be amended so that it would be flexible enough to accommodate this type of system, which might be referred to as a system for effecting “high-speed electronic payments”. Each proposed revision is set forth below, and is explained in a short comment.

Proposed new paragraph (3) of article 1

“(3) If a credit transfer is a ‘high-speed electronic transfer’, this law applies if any payment order comprising the credit transfer is sent from a sender located in one State to a receiving bank in another State.”

Comment

Funds transfer systems like the Clearing House Interbank Payments System (“CHIPS”) process high-speed electronic transfers. Typically, these transfers are initiated by banks that may be located outside of the United States, but that transmit by wire payment orders that are to be executed by banks located within the United States. Such a CHIPS payment might terminate with a credit to the account of a beneficiary at a bank located within the same State as the originator’s bank. This type of transfer would not be covered under the draft Model Law, because under article 1, section (1), the originator’s bank and the beneficiary’s bank are in the same State. Proposed section (3) of the draft Model Law increases the scope of the Model Law so that it covers what are defined in article 2 as “high-speed electronic transfers”.

Proposed new subparagraphs (m) and (n) of article 2

“(m) ‘High-speed electronic transfer’ means a credit transfer involving any payment order that is sent through a funds transfer system, which system is used primarily to process payment orders that are (i) sent electronically between banks or between businesses, (ii) intended to transfer value on the same day, and (iii) settled on the books of a bank or a Central Bank.”

“(n) ‘Funds transfer system’ means an electronic transfer network, automated clearing house, or other communication system of a clearing house or other association of banks through which a payment order may be transmitted to the bank to which the order is addressed.”

Comment

Section (m) defines the characteristics of the “high-speed electronic transfer” which will merit coverage under the draft Model Law, subject to the “contracting out” provision which is recommended for article 16. Note that such a credit transfer must contain at least one payment order that is processed by a special type of funds transfer system. That funds transfer system must be one that is used primarily for processing payment orders that are communicated electronically (that excludes instruments which are widely used in some States), and are primarily commercial transfers (that excludes most giro and point of sale systems, which are primarily consumer systems). Further, such a funds transfer system must be used primarily for payments that are not for a future value (which would eliminate most conditional payments), and settlement of the order would be on the books of a bank or a Central Bank. The purpose of the definition is to identify credit transfers like transfers made through CHIPS, which will need to be subject to rules that accommodate their high speed, maximum security, and low cost nature.

Section (n) defines what is a funds transfer system. No credit transfer can be a “high-speed electronic transfer” unless at least one payment order is effected through such a system. Again, the definition is sufficiently broad to encompass organizations like CHIPS and SWIFT.

Proposed new paragraph (3) of article 15

“(3) A funds transfer system may select the law of a particular State to govern the rights and obligations of all parties to a high-speed electronic transfer. In the event of any inconsistency between any provision of the law of the State selected by the funds transfer system and any provision of this Model Law, the provision of the law of the State selected by the funds transfer system shall prevail.”

Comment

Because a high-speed funds transfer system may involve parties located in several States, and because the rights and liabilities of one party may be affected by the action taken by another, it is particularly important to have one set of rules govern all parties to a high-speed credit transfer. These factors led CHIPS to announce the following rule in April of 1990.

“The rights and obligations of participants and all other parties to a funds transfer of which a CHIPS payment message is a part, arising from the funds transfer or from these Rules, shall be governed by the law of the State of New York. A ‘funds transfer’ means the series of transactions, beginning with the originator’s payment order, made for the purpose of making payment to the beneficiary of the order and includes any payment order issued by the originator’s

bank or an intermediary bank intended to carry out the originator's payment order."

Proposed article 15(3) enables funds transfer systems to promulgate rules like new CHIPS rule 3. It avoids the possibility of a single funds transfer being subject to conflicting substantive provisions of State law, thereby increasing the predictability and certainty of result that are the hallmarks of commercial law.

Proposed new article 16

"Article 16. *Variation by agreement and effect of funds transfer system rule*

(1) Except as otherwise provided in this law, the rights and obligations of a party to a credit transfer may be varied by agreement of the affected party.

(2) 'Funds transfer system rule' means a rule of an association of banks (i) governing transmission of payment orders by means of a funds transfer system of the association or

rights and obligations with respect to those orders, or (ii) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a Central Bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank. Except as otherwise provided in this law, a funds transfer system rule governing rights and obligations between participating banks using the system may be effective even if the rule conflicts with this law and indirectly affects another party to the funds transfer who does not consent to the rule."

Comment

It is possible that a funds transfer system processing high-speed credit transfers, or two parties to a part of a credit transfer, might want to adopt the Model Law, with some variation. Article 16 permits this, and embodies a policy judgement that parties to a credit transfer should be able to contract out of those provisions which are unsuitable to their specific purposes.

**E. Report of the Working Group on International Payments
on the work of its twenty-second session
(Vienna, 26 November-7 December 1990) (A/CN.9/344)
[Original: English]**

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INTRODUCTION

1. At its nineteenth session, in 1986, the Commission decided to begin the preparation of Model Rules on electronic funds transfers and to entrust that task to the Working Group on International Negotiable Instruments, which it renamed the Working Group on International Payments.¹

2. The Working Group undertook the task at its sixteenth session (Vienna, 2-13 November 1987), at which it considered a number of legal issues set forth in a note by the Secretariat (A/CN.9/WG.IV/WP.37). The Group requested the Secretariat to prepare draft provisions based on the discussions during its sixteenth session for consideration at its seventeenth session (A/CN.9/297). At its seventeenth session (New York, 5-15 July 1988) the Working Group considered the draft provisions prepared by the Secretariat (A/CN.9/WG.IV/WP.39). At the close

¹See *Official Records of the General Assembly, Forty-first Session, Supplement No. 17 (A/41/17)*, para. 230.

of its discussions the Working Group requested the Secretariat to prepare a revised draft of the Model Rules (A/CN.9/317). At its eighteenth session (Vienna, 5-16 December 1988) the Working Group began its consideration of the redraft of the Model Rules, which it renamed the draft Model Law on International Credit Transfers (A/CN.9/318). At its nineteenth, twentieth and twenty-first sessions it continued its consideration of the draft Model Law (A/CN.9/328, A/CN.9/329 and A/CN.9/341).

3. The Working Group held its twenty-second session at Vienna from 26 November to 7 December 1990. The Group was composed of all States members of the Commission. The session was attended by representatives of the following States members: Argentina, Bulgaria, Cameroon, Canada, Chile, China, Czechoslovakia, Denmark, Egypt, France, Germany, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Libyan Arab Jamahiriya, Mexico, Morocco, Netherlands, Singapore, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, and United States of America.

4. The session was attended by observers from the following States: Australia, Austria, Bolivia, Colombia, Democratic People's Republic of Korea, Dominican Republic, Finland, Indonesia, Kuwait, Lebanon, Oman, Peru, Philippines, Poland, Republic of Korea, Saudi Arabia, Sweden, Switzerland, Thailand, Turkey, Uganda, United Arab Emirates, and Zaire.

5. The session was attended by observers from the following international organizations: International Monetary Fund, Asian-African Legal Consultative Committee, Bank for International Settlements, Commission of the European Communities, Hague Conference on Private International Law, Banking Federation of the European Community, Latin American Federation of Banks and Society for Worldwide Interbank Financial Telecommunication S.C.

6. The Working Group elected the following officers:

Chairman: Mr. José María Abascal Zamora
(Mexico)

Rapporteur: Mr. Bradley Crawford (Canada).

7. The following documents were placed before the Working Group:

(a) Provisional agenda (A/CN.9/WG.IV/WP.48);

(b) International Credit Transfers: Comments on the draft Model Law on International Credit Transfers, Report of the Secretary-General (A/CN.9/WG.IV/WP.49).

8. The Working Group adopted the following agenda:

(a) Election of officers.

(b) Adoption of the agenda.

(c) Preparation of Model Law on International Credit Transfers.

(d) Other business.

(e) Adoption of the report.

9. The following documents were made available at the session:

(a) Report of the Working Group on International Payments on the work of its sixteenth session (A/CN.9/297);

(b) Report of the Working Group on International Payments on the work of its seventeenth session (A/CN.9/317);

(c) Report of the Working Group on International Payments on the work of its eighteenth session (A/CN.9/318);

(d) Report of the Working Group on International Payments on the work of its nineteenth session (A/CN.9/328);

(e) Report of the Working Group on International Payments on the work of its twentieth session (A/CN.9/329);

(f) Report of the Working Group on International Payments on the work of its twenty-first session (A/CN.9/341).

I. CONSIDERATION OF DRAFT PROVISIONS FOR THE MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS

10. The text of the draft Model Law before the Working Group was that set out in the report of the twenty-first session of the Working Group (A/CN.9/341, annex) and reproduced with comments in A/CN.9/WG.IV/WP.49.

Article 12

Subparagraph (5)(d) and paragraph (8)

11. The Working Group recalled that at its twenty-first session there had been a discussion of subparagraph (5)(d) and that a suggestion had been made to delete it as well as paragraph (8). A similar suggestion had been to combine subparagraph (5)(d) and paragraph (8). Under that proposal the Model Law would not provide a standard by which to determine whether a party to the credit transfer could recover consequential damages from a bank that had acted improperly. Instead, a bank would be subject to such rules of law otherwise existing in the national legal system when it acted in the ways described in the current text of subparagraph (5)(d). In opposition to both suggestions it had been pointed out that the purpose of paragraph (8) was to preserve the unity of the law in regard to the remedies available to a party to an international credit transfer, a unity that the Model Law sought to achieve in general. It had also been stated that one of the purposes of paragraph (8) was to protect the banking system from unexpected claims for substantial amounts based on rules of law outside the Model Law. The Working Group had agreed that it needed more time to study the implications of the suggestions that had been made. It had decided to place both texts in square brackets for reconsideration at the current session (A/CN.9/341, paras. 126-131).

12. At the current session the Working Group considered a new proposal to delete subparagraph (5)(d) and to add at the end of the current text of paragraph (8) the following words based upon subparagraph (5)(d):

“save any under which a bank is liable to compensate for loss because the improper or late execution or failure to execute resulted from an act or omission of that bank done with the intent to cause such loss, or recklessly and with knowledge that such loss might result.”

13. In support of the proposal it was stated that, if subparagraph (5)(d) and paragraph (8) were simply deleted, it would be unclear whether remedies arising out of other rules of law would be available in cases where a bank acted wilfully with the intention of causing harm or recklessly with the knowledge that harm might result. It was also said that it was appropriate for the Model Law to contain a provision making it clear that in case of intentional or reckless behaviour, the bank might have to pay consequential damages in addition to an obligation to compensate for loss of interest and for expenses incurred for a new payment order, as otherwise provided in paragraph (5).

14. In opposition to the proposal, it was stated that any provision allowing for consequential damages would imply that in case of litigation an attempt would be made to determine the intent of the bank. It was also said that in some legal systems a party was deemed to have intended the consequences of its acts. In those systems it would be at least a question for the trier of fact, which might be a jury of ordinary citizens, whether the bank intended the harm when harm resulted from a failure by a bank to act with due care. It was said that an attempt to determine the intent of the bank would not be compatible with the operation of automated high-value, high-speed funds transfer systems. Therefore, it was stated, subparagraph (5)(d) should be deleted and paragraph (8) should be retained without change.

15. Another view was that subparagraph (5)(d) should be maintained to state the principle that a bank should be responsible for the consequences of its acts and that responsibility for intentional or reckless acts was the minimum that the Model Law should envisage. It was stated that this should be done even if paragraph (8) was amended as suggested.

16. The discussion in the Working Group focused on the specific wording of the proposal. A concern was expressed by some delegates that the concept of doing an act “recklessly”, used in both the current text of subparagraph (5)(d) and the new proposal, was unclear and would lead to difficulties of interpretation, especially in legal systems where the concept was not currently in use. It was stated that the concept might be interpreted differently in different jurisdictions. For example, it was stated that in some jurisdictions failure to execute a given payment order might be interpreted as reckless behaviour even though the situation should be treated as ordinary negligence of the bank. In order to avoid those difficulties, it was suggested that the concept should either be defined within the Model Law or deleted altogether. In response

to that suggestion, it was noted that the current wording of subparagraph (5)(d) had been used in several international texts, including for example the Convention on Certain Rules Relating to International Carriage by Air (Warsaw, 1929) and the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules) and, it was stated, no significant difficulties of interpretation had arisen. Furthermore, the aim of the proposal was not to create a general regime of liability for consequential loss applying in the cases where the banks had acted recklessly or with intent to cause the loss. In effect, the proposed deletion of subparagraph (5)(d) combined with the amendment of paragraph (8) would only allow the individual States whose law other than the Model Law provided such a remedy to apply that remedy to a bank that had acted improperly in the ways described in the proposed wording of paragraph (8). The crucial question would be whether and under what conditions the law of the State, other than the Model Law as adopted by that State, would provide for consequential damages. Therefore, it was not necessary to be assured that the word “recklessly” would be applied in exactly the same way in all States, or even that the concept of “recklessness” existed in the law of all States. A view was expressed that analogies between the international texts cited and credit transfers were inappropriate because of the high-speed, high-volume nature of credit transfers and other differences in the subject-matter.

17. A suggestion was made that a general provision on the uniform interpretation of the Model Law should be included to help overcome possible difficulties in the use of the concept of recklessness, but there was no support for that suggestion.

18. It was stated that the proposed text was appropriate because under many national laws parties to a contract could not validly agree to exclude liability for their own intentional misconduct. The proposed text would retain such a rule in those States.

19. A proposal was made to amend the proposed addition to paragraph (8) to delete the words “or recklessly”. Under that proposal the end of paragraph (8) would read “resulted from an act or omission of that bank done with the intent to cause such loss and with knowledge that such loss would result.” The proposal was objected to on the grounds that it would put an excessive burden on the bank customer to have to prove both the intent of the bank and knowledge by the bank of the effect that would result from its failure to execute properly. No support was expressed in favour of the proposal.

20. Another proposal would have deleted the words “or recklessly and with knowledge that such loss might result” so that the end of paragraph (8) would have read “resulted from an act or omission of that bank done with the intent to cause such loss.” In response to the proposal it was said that, if paragraph (8) were to address only the case of intentional failure to execute, it could be interpreted as excluding the availability of consequential damages in the cases where the bank acted without caring at all but with no actual intent to cause the loss. It was said that the simple deletion of paragraph (8) would be preferable to such a result. A concern was expressed that the word

"might" was so broad as to leave the last clause without any standard, thereby creating an unacceptably large scope for liability.

21. At the end of its discussion the Working Group recalled that it had to decide: whether a provision of the Model Law should state that consequential damages would be available, for example under the circumstances described in the current version of subparagraph (5)(d); whether the Model Law should state that consequential damages would never be available; or whether the Model Law should leave the matter to national law outside the Model Law. It was noted that this last policy could be implemented either by deleting both subparagraph (5)(d) and paragraph (8) from the Model Law or by deleting subparagraph (5)(d) and rewording paragraph (8) in the manner set forth in paragraph 12 of the present report. After discussion and consideration of the reservations expressed by several delegations, the Working Group decided to adopt the text set forth in paragraph 12.

22. The Working Group noted that the deletion of subparagraph (5)(d) would entail consequential drafting changes to paragraph (7).

Paragraph (6)

23. The Working Group considered a proposal to redraft paragraph (6) to read as follows:

"(6) This paragraph applies to a receiving bank which is liable only in respect of its failure or the failure of a subsequent receiving bank to comply with any of the following notification obligations:

(a) to notify rejection in accordance with article 5(3) or 7(2), where payment has not been received from the sender;

(b) to notify misdirection in accordance with article 6(3) or 8(2);

(c) to notify a lack of sufficient data in accordance with article 6(4) or 8(3);

(d) to notify an inconsistency between the words and figures that describe the amount of money in accordance with article 6(5) or 8(4).

If a bank to which this paragraph applies is liable under this article to the originator or to its sender, it is obliged to compensate only for loss of interest for a maximum of 7 days or the period during which it held the funds, whichever is the longer."

24. It was stated by its proponents that the proposal was intended to include sanctions for all failures to give a notice required by the Model Law, except for the duty of a receiving or beneficiary's bank that had received payment to notify the sender of a rejection of the payment order (for which articles 5(2)(a) and 7(1)(a) provided the consequences) and the duty of the beneficiary's bank to notify an intended beneficiary who did not maintain an account at the bank that it was holding funds for his benefit (article 8(6)). It was also stated that the proposal aimed at reducing the maximum period of time that interest would be due by the bank to the sender in case of a misdirected payment order where no funds had been made

available to the bank from 30 days (as in the current text of article 12(6)(b)) to 7 days. It was noted that the reference to "payment" in subparagraph (a) would have to be made consistent with the wording adopted in articles 5(2)(a) and 7(1)(a) (see paragraph 68).

25. It was suggested that the Working Group should not discuss the sanctions for a failure to give a required notification before a final decision had been made as to the contents of the duties to notify and the time when those duties would have to be complied with. Although the view was expressed that the contents of the duties should be considered first, the prevailing view was that consideration of the sanctions might help to understand the nature of the obligations and the advisability of imposing them.

26. A discussion took place as to whether there existed a need for the Model Law to address the issues arising from the misdirection of payment orders. Under one view the duties to notify should be limited to the two cases where a bank decided to reject a payment order and where a bank had to provide assistance to the sender of a payment order under article 11(a). Another view was that there was no need to consider the issue of misdirected payment orders because they were rare in practice. Furthermore, obligations should be created only when a bank had received a payment order addressed to it. In reply it was stated that, however rare misdirected payment orders might be, it was appropriate for the Model Law, as a matter of public policy, to protect the sender against the consequences of a misdirected payment order. Furthermore, it was said, misdirected payment orders were not that rare in international credit transfers, particularly when two banks had similar names.

27. It was suggested that different solutions might be needed where the sender and the receiving bank of the misdirected payment order had an account relationship and where there existed no such relationship. It was stated that where the sender and the receiving bank had an established relationship, there was no need to create a new duty binding upon the receiving bank because the bank would already have an implied contractual duty to notify misdirection of the payment order. It was also stated that where no established relationship existed between the sender and the receiving bank, it might be particularly appropriate for the Model Law, as a matter of public policy, to create such a duty to give notice to the sender.

28. A view was expressed that the Working Group should consider the situation where a payment order was mistakenly sent to a receiving bank where the sender had an interest bearing account but the account had an insufficient credit balance to cover the payment order. It was stated that, in this case, the provisions in articles 5(2)(a) and 7(1)(a) deeming an acceptance to occur upon failure to notify the sender of rejection of the payment order would not apply. The question was raised as to whether the proposed sanction in case of a failure to notify would modify the amount of interest normally accruing to the account. In response, it was stated that the duty to notify the sender of a misdirected payment order did not provide a claim for damages if no loss had been suffered by

the sender. It was stated that, under the proposed text, the obligation of the receiver of a misdirected payment order was to "compensate for loss of interest". It was stated that no duty and therefore no sanction would apply unless funds had been transmitted for the purpose of funding the particular payment order.

29. It was recalled that where the receiving bank had received funds with the misdirected payment order, it would in any circumstances be under an obligation to return the funds with interest under article 11(b) (see paragraphs 105 to 111). A view was expressed that, since the receiving bank would be under the obligation to return the funds with interest under article 11(b), there was no need to specify any sanctions under article 12. The prevailing view was that article 12 should contain a provision in respect of misdirected payment orders so as to prevent unjustified enrichment of the receiving bank.

30. As regards the situations described in subparagraphs (b) to (d) of the proposal where no funds had been received by the receiving bank, a view was expressed that the principle of liability under article 12 should also be retained. It was stated that such liability would not overburden the banks since it would arise only in rare cases and would lead to limited sanctions. That suggestion was objected to on the grounds that no interest should be recoverable from the receiving bank where it had not received funds. The Working Group decided that the proposed provisions of paragraph (6)(b) to (d) should not apply where no funds had been received by the receiving bank. In furtherance of that approach, it was decided that the liability should be imposed only upon the bank that received the funds, so that banks would have no responsibility for failures of subsequent banks to notify of a misdirected payment order.

31. As regards subparagraph (a) of the above stated proposal, a view was expressed that a duty to notify rejection of the payment order should be maintained as a matter of public policy so as to protect the sender, for example in the situation where a bank would unduly delay payment by refusing to make the appropriate entries into an account. In response, it was stated that in such a situation where funds had effectively been sent to the receiving bank, the sender was sufficiently protected by the fact that the receiving bank would be regarded as having accepted the payment order. After discussion, the Working Group decided not to retain subparagraph (a) of the proposal.

32. It was stated that subparagraphs (b), (c) and (d) placed liability on a receiving bank even though the error was the sender's and, given the liability for errors in execution elsewhere in article 13, penalizing an innocent receiving bank for a sender's error was inappropriate.

33. At the conclusion of the discussion the Working Group decided to retain the proposed text of subparagraphs (b) to (d) of article 6 where the receiving bank had received the funds to pay for the payment order.

34. A discussion took place as to the definition of the interest and the applicable rate. The Working Group re-

called that, at its twenty-first session, it had decided not to attempt to define a rate of interest or a means of determining that rate (A/CN.9/341, paras. 121 to 123).

35. The Working Group then turned to the question as to whether a bank should be responsible for the failure of a subsequent receiving bank to give a required notice, as set forth in the *chapeau* of the proposal. The Working Group decided to delete the words "or the failure of a subsequent receiving bank".

Paragraph (7)

36. The Working Group noted that it had decided to delete subparagraph (5)(d) (see paragraph 21) and that the reference to that subparagraph should therefore be deleted from the text of paragraph (7).

37. The attention of the Working Group was drawn to the fact that the principle of freedom of contract set forth in the first sentence of paragraph (7) was currently expressed in article 16. It was therefore agreed that at least the first sentence could be deleted as being unnecessary.

38. It was proposed that the entire text of paragraph (7) should be deleted because it reflected a lack of confidence regarding the banks. In support of that proposal it was stated that, in the context of the paragraph, the Model Law should not attempt to give special protection to bank customers, whose bargaining power might well be equal or superior to that of the banks. Under another view the general principle of freedom of contract in article 16 should be deleted. The prevailing view, however, was that the second sentence should be maintained as there existed a need to set a minimum standard for the protection of bank customers.

39. Another suggestion was that express reference should be made to the possibility that the parties might exercise their right under paragraph (7) to modify the liability regime by use of standard contractual clauses. In explanation it was said that in certain States it was not possible to modify the legal regime of responsibility except by an express contract and that clauses of non-responsibility found in standard form contracts were not enforceable. After discussion, the Working Group decided that such an amendment would be useful and referred the matter to the Drafting Group.

Paragraph (2)

40. The Working Group recalled that the general system of liability set forth in paragraph (2) was that the originator could hold the originator's bank liable for the improper performance of the credit transfer. That made the originator's bank responsible to the originator for loss wherever the loss occurred. The originator's bank and each successive receiving bank could in turn hold its receiving bank liable for the improper performance of the transfer when the improper performance occurred at that bank or at a subsequent bank in the credit transfer chain. The types and extent of the losses for which the originator's bank would be liable were those set forth in paragraph (5).

41. The Working Group based its discussion on a draft it had requested the Secretariat to prepare for the implementation of the policy decisions made at its twenty-first session. The proposed draft read as follows:

"A receiving bank that is not the beneficiary's bank that accepts a payment order is liable to its sender and to the originator for the losses as set out in paragraph (5) of this article caused by a delay in the completion of the credit transfer, a failure to complete the credit transfer or a failure to complete it as instructed in the originator's payment order. A receiving bank is liable under subparagraph (5)(d) only to the extent that its actions caused the loss."

42. The Working Group noted that as a result of the decision to delete subparagraph (5)(d) (paragraph 21 above) the second sentence of the proposal could be deleted. The Working Group also noted that following the decision to delete subparagraph (5)(d) the originator's bank would be liable to the originator only for loss of interest and for expenses incurred for a new payment order.

43. A view was expressed that, since the deletion of subparagraph (5)(d) would, in essence, restrict the applicability of the liability regime set forth in paragraph (2) to loss of interest, there might be little justification left for the regime. It was recalled that, at previous sessions, the Working Group had decided that the interest due for delay in the execution of the credit transfer should be passed down the credit transfer chain to the beneficiary. It was noted that that policy decision had not as yet been implemented in the text of the Model Law.

44. The Working Group discussed the relationship between the obligation under article 11(b) to refund the principal amount of the transfer to the originator when the credit transfer was not completed and the liability for interest under article 12. The example was given of an intermediary bank that issued to its receiving bank a payment order for a smaller amount than the amount in the payment order it had received from the originator's bank. It was said that, if the intermediary bank subsequently sent a second payment order for the missing amount, the beneficiary should receive the interest for the delay in regard to that amount. However, if the missing amount was not sent forward so as to complete the credit transfer as instructed by the originator, the missing amount should be returned to the originator under article 11(b) and, it was said, interest should be paid to the originator on that amount. It was said that the beneficiary should not be able to recover interest while the originator recovered the principal sum. If the beneficiary had a right to interest from the originator for delaying in paying the underlying obligation, it should recover that interest from the originator, along with the amount not transferred to it in the original transfer.

45. In accord with the analysis set forth in the previous paragraph, a proposal was made to amend article 11(b) to provide that, where a credit transfer was not completed, the duty should be to refund "with interest". In reply it was said that such an obligation regarding interest would be appropriate in article 12 as a rule on liability, but not

in article 11, which operated so as to guarantee the completion of the credit transfer. In response, it was said that it was only logical that the receiving bank that had retained funds for some time in a credit transfer that was not completed should not only refund those funds to its sender, but that it should pay interest on those funds for the period of time during which it had had use of them. After discussion, the Working Group adopted the proposal to add the words "with interest" to article 11(b).

46. The Working Group noted that, having added the words "with interest" to article 11(b), it had provided that the originator would receive the interest in case of a credit transfer that was not completed. It therefore reaffirmed the decision it had taken at an earlier session that the beneficiary should receive the interest allowable as damages under article 12 in case of a credit transfer that was completed, but was delayed.

47. It was said that, even if the beneficiary should have the primary right to receive interest for a delayed transfer, the originator should have a residual right to recover the interest. The example was given of a beneficiary to whom the interest was not paid and who recovered interest from the originator because of the delay in payment of the underlying obligation as suggested in paragraph 44. In reply it was said that, although the originator should undoubtedly be able to recover the interest in such a case, such a right should not be available under the Model Law. Instead, it was said, the originator's right to exercise the claim of the beneficiary should be left to the otherwise applicable law of subrogation or other appropriate doctrine. That solution was objected to on the grounds that it would deprive the originator of the vicarious liability of the originator's bank provided for in paragraph (2).

48. It was suggested that it should be clear in the Model Law that the failure of a sending bank to furnish cover to its receiving bank, as a result of which the receiving bank delayed its execution of the payment order, was one failure for which the sending bank should be liable for interest. In reply it was said that the duties of the sending bank, in its capacity as receiving bank of the order it had received, should be set forth in article 6 and not in article 12. In any case, its obligation as a sending bank under article 4(4) was to pay its receiving bank for the payment order when that receiving bank accepted it. It was agreed that further study of the question was needed.

49. The question was raised as to the party from whom the beneficiary should have the right to receive the interest. It was stated that it would be appropriate for the Model Law to provide a mechanism similar to that in the current text of paragraph (2) to the effect that, in case of late execution of the credit transfer, the beneficiary's bank would be liable to the beneficiary for interest wherever the delay occurred. It would then be necessary to provide that the beneficiary's bank had a right of recourse against its sender and that the liability would be passed up the credit transfer chain to the bank that was responsible for the delay. The objection was raised that making the beneficiary's bank liable for the actions of an intermediary bank up the credit transfer chain would make it liable for actions that had occurred before it had had any awareness

of the existence of the transfer and would possibly discourage it from accepting a payment order to complete a credit transfer that had been delayed. Moreover, while it had a contractual relationship both with the beneficiary and with its sender, it had no such relationship with a remote intermediary bank.

50. While it was acknowledged that there was the same lack of contractual relationship between the beneficiary and an intermediary bank, the Working Group was of the view that it was more appropriate to give the beneficiary a direct right against the bank at which the delay in the transfer occurred than to impose liability upon other banks for delays occurring before they acted in a credit transfer.

51. The Working Group recognized that good banking practice would call for the bank at which the delay occurred to forward the appropriate amount of interest to its receiving bank. It would be difficult and relatively expensive for the beneficiary to make its claim directly against the intermediary bank, especially when that bank was in a foreign country. It would be much better for all concerned if the intermediary bank were to pay any interest incurred by it without the need for a claim to be made against it. In order to foster such a desirable practice, the Working Group adopted in principle the following proposal:

"The liability of the bank to the beneficiary is discharged to the extent that it transfers to its receiving bank an amount in addition to that it received from its sender."

52. In further support of the decision that the interest due from the intermediary bank that had delayed the execution of a payment order should be passed forward to the beneficiary through the banking system, the Working Group adopted the following provision:

"If the receiving bank that is the recipient of interest for delay [including by means of an appropriate adjustment in the date of the entry of the debit or credit to an account] is not the beneficiary of the transfer, the receiving bank shall pass on the benefit of the interest to its receiving bank."

53. The question was raised whether the Model Law should specifically state that one way for a sending bank to pay interest to its receiving bank was to make an appropriate adjustment in the date of the credit. An objection was raised that the date of the credit might be adjusted in an account that did not bear interest, thereby being of no benefit to the receiving bank. In response, it was stated that the reference to an "appropriate" adjustment made it clear that such adjustment should lead to the production of interest. The substance of the proposal was adopted by the Working Group. However, it was stated that adjustment in the date of the credit might not be the only way by which a bank might pay the interest due. Reference was made to the possible use of a set-off mechanism. The Working Group decided to refer the matter to the Drafting Group.

54. A discussion took place as to whether interest should be due merely because of a delay in the execution of a payment order or whether only a delay in the completion

of the credit transfer should create a claim for interest in favour of the beneficiary. A delay in the execution of a payment order, it was stated, should give no claim to the beneficiary if the delay was made up at a later point in the credit chain and the credit transfer was completed by the payment date that had been stipulated. In reply it was said that a rule that relied on a delay in the completion of the credit transfer would be difficult to administer. Such a rule would mean that the intermediary bank would not know whether it was liable to pay interest until it had notice as to whether the credit transfer had been completed on time or not.

55. At the end of the discussion, the Working Group noted that it had adopted the following principles to be implemented by the Drafting Group in its redraft of paragraph (2): late completion of the credit transfer gives the beneficiary a claim for interest against the bank that caused the delay; a bank that does not properly execute a payment order is at fault and must pay interest; the intermediary bank that caused the delay is discharged from its liability if it passes interest to its receiving bank; the interest must be passed down the credit transfer chain by each receiving bank until it reaches the beneficiary. The Working Group noted that it had decided that the Model Law would not specify the rate of interest that would apply in such cases, but that it was proceeding on the assumption that it would be an interbank rate.

Proposed new paragraph

56. It was suggested that the Model Law should address the case where a bank that was obligated to pay interest to its sender (or, in accord with the decisions made at this session, to its receiving bank) and that in turn had a right of reimbursement of that interest, could not recover the reimbursement because that party had become insolvent. The suggestion was made that such a bank should be entitled to recover the reimbursement from any other bank further up or down the credit transfer chain, as the case may be, if that other bank would itself have been obligated to reimburse the insolvent bank.

57. In reply it was noted that such a rule would be of much greater significance in the context of the obligation to reimburse the principal sum under article 11(b). However, it was stated that, although such a rule appeared on first analysis to be a fair rule, a thorough economic analysis would show that it was incompatible with a bilateral or multilateral netting scheme; since the Working Group had decided that it should support the development of such netting schemes by including a rule on the time of payment of a receiving bank made through such a scheme, it would not at the same time be able to adopt the proposed rule. After discussion the Working Group decided not to adopt the proposal.

Article 13

58. In the light of the decisions taken by the Working Group regarding the rules on liability set forth in the Model Law, the view was expressed that, since liability existed only for interest, there was no need to maintain a

rule on exemption. After discussion, the Working Group decided to delete article 13.

Payment to receiving bank

59. The Working Group noted that there was no rule in the current text of the Model Law to indicate when the sender fulfilled its obligation to pay the receiving bank under article 4(4). It noted that payment to the receiving bank might be made either through correspondent banking relations or through a multilateral or bilateral netting arrangement.

60. The Working Group noted that the "Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries", which had been presided over by the Managing Director of the Bank for International Settlements, had been published during the month of November 1990. The Working Group noted that the report dealt with policy issues in regard to interbank netting schemes, including payment netting schemes, but that it did not attempt to draft any legal text to implement its policy determinations. The conclusions of the report set forth minimum standards for netting schemes. The first of those minimum standards was that "Netting schemes should have a well-founded legal basis under all relevant jurisdictions." The Working Group noted that for there to be a well-founded legal basis for the netting scheme, it would be necessary that the netting scheme would not only be valid under the civil or commercial law, but that it would also be effective under the law of insolvency. It was also noted that in Part C of the report of the committee on netting schemes it was indicated that the netting scheme would have to function as intended under the law of all relevant States, which included (a) the law of each of the parties to the netting scheme, (b) the law that governed the individual transactions subject to the netting scheme, and (c) the law that governed any contract or agreement necessary to effect the netting.

61. It was stated that the legal issues involved in assuring the existence of a well-founded legal basis for bilateral and multilateral netting schemes had not yet been completely examined. It was said that those issues would be further studied in the work of the committee on netting schemes. It was suggested that until those studies had been completed, it would be unwise for UNCITRAL to attempt to include any provision on the subject in the Model Law. It was said that it could be envisaged that at a later time such a provision might be included. There was general agreement that the report of this session should recommend to national legislators that domestic laws, especially laws dealing with bankruptcy and insolvency, should be reviewed with the objective of supporting interbank netting of payment obligations.

62. Before making a final decision on the question as to whether the Model Law should include any provision intended to give a legal basis to netting schemes, the Working Group decided to turn to the issue of the time when the sender pays the receiving bank. It noted that in A/CN.9/WG.IV/WP.49, comments 31 to 45 to article 4, that issue had been considered in respect of correspondent

banking before it was considered in respect of netting arrangements, since the issues were simpler in the context of correspondent banking. It was noted that an important reason for determining when the sender paid the receiving bank for the payment order was to be able to establish the amount in the account at any point of time in case of the insolvency of either the sender or the receiving bank or in case of attachment or other legal process against the account.

Sender has account with receiving bank

63. The discussion in the Working Group was based on the following proposal:

"Payment of the sender's obligation under article 4(4) to pay the receiving bank occurs:

(a) If the receiving bank debits an account of the sender with the receiving bank, when the debit is made, to the extent the debit is covered by a withdrawable credit balance in the account."

64. Under one view payment should be considered to be made at the time that the receiving bank had a right of setoff of the amount of the payment order against the account of the sender. The debiting of the account should be considered to be merely a bookkeeping entry with no independent legal significance.

65. Under another view it was appropriate for payment to be considered to have been made only when the account was debited. The act of debiting the account manifested the decision of the receiving bank that it was able and willing to receive payment in that manner. Even if the account was debited by a computer without human intervention, it had been programmed to do so only under certain conditions, thereby manifesting the decision of the receiving bank. Such a rule would not preclude the possibility that under the applicable law the receiving bank might have a right of setoff prior to the time of payment. It was noted that it was also possible for the receiving bank to debit the account prior to having a right of setoff. One example of such a possibility would be that the receiving bank might debit the account prior to executing the payment order received from the sender in order to be sure that it had been paid before it undertook its own obligation as sender to pay the receiving bank of its payment order.

66. Under one suggestion the words "to the extent of" should be replaced by "and". In support it was noted that it was not sufficient that there be "available credit" in the account, but that the credit should be withdrawable.

67. Under another suggestion the words "to the extent the debit is covered by a withdrawable credit balance in the account" should be deleted from the proposal. It was stated that it was not clear whether there was a withdrawable credit balance under either of two situations: when the account had a debit balance, or when the account had an insufficient credit balance to cover the amount of the payment order, but in either case there was a line of credit from the receiving bank to the sender

sufficient to cover the payment order. It was also questioned whether those words would permit a receiving bank to claim that its action in debiting the account did not constitute payment to it when the bank later discovered that there had been no withdrawable credit in the account or that credit had not been sufficient.

68. The Working Group noted that subparagraphs 5(2)(a) and 7(1)(a) both provided that the receiving or beneficiary's bank was deemed to accept a payment order by failing to give notice of rejection where the receiving or beneficiary's bank had been paid for the order. It was noted that it would be improper to allow the bank to avoid the effects of its failure to give notice of rejection by simply failing to debit the sender's account. It was, therefore, decided that the drafting of those subparagraphs should be modified to retain their current policy in the light of this discussion.

69. The Working Group, after discussion, decided to adopt the proposed text but to delete the words "to the extent the debit is covered by a withdrawable credit balance in the account".

Receiving bank has an account with sender or third bank

70. A proposal was made to add to the proposal set forth in paragraph 63 the following:

"(b) If the sender is a bank and the sender (i) credited an account of the receiving bank with the sender, or (ii) caused an account of the receiving bank in another bank to be credited, when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank learns of that fact."

71. The Working Group was in agreement with the proposal that payment should be considered as having been made to the receiving bank at the latest when the credit was withdrawn. It noted that in most cases the credit would not be withdrawn in specific terms, since the credit and any debit that might be considered to represent the withdrawal would be part of a continuous series of transactions through the account. The Working Group also noted that in some legal systems credits to an account are considered to have been withdrawn in the order in which they were made to the account.

72. The Working Group agreed with the principle that, in respect of a credit that had not been withdrawn, the receiving bank should have a certain period of time after learning of the credit to decide whether it wished to receive payment in that manner. It was noted that the receiving bank might not wish to receive payment by credit with the bank in question, even though it had an account with that bank, in order, for example, to manage its credit exposure to that bank. It was suggested that the problems were somewhat different when the credit was to an account with the sender and when the credit was to an account with a third bank. Consequently, it was said, the two situations should be treated independently in the Model Law.

73. It was stated that the receiving bank would often need additional time when the credit was in a foreign currency that it might need to convert to its own currency before it could use the credit effectively. In reply it was stated that international credit transfers to settle foreign exchange contracts were scheduled ahead of time and that the receiving bank would already have made commitments for the use of the funds. However, a large and unexpected credit in a foreign currency could cause such problems.

74. It was suggested that the time for payment should be extended to midnight of the day following the day on which the credit was withdrawable. While there was general agreement with the suggestion to the extent that it extended the time of payment to the next day, it was said that midnight had no relevance to banking operations in many countries. On the one hand the processing of transactions was completed earlier than midnight in many countries. To accommodate this point of view it was suggested that the proposed text should refer to the end of the banking day. On the other hand the movement to 24-hour banking, including the sending and receiving of international credit transfers, made any point of time arbitrary.

75. It was stated that the point of time when payment took place should be measured at the location of the receiving bank. Under another view it should be measured at the location of the sender. Under yet a third view it should be measured at the location where the account was located, which would be either the location of the sender or of the third bank.

76. A proposal was made to amend the text under consideration to provide "or, if not withdrawn, on the business day following the day on which . . .". It was noted that this proposal did not attempt to specify exactly when on that following day the receiving bank would be considered to have been paid by the sender.

77. Another proposal was to replace the words "the credit is withdrawable" by the words "the receiving bank is in a position to make effective the withdrawal". In opposition it was stated that the proposal would seem to leave the determination as to whether the receiving bank was in a position to withdraw the credit depend on the bank's subjective situation.

78. It was stated that the receiving bank should not be considered to have received payment unless the credit remained withdrawable throughout the entire period of time. It was stated that a credit would be considered to be withdrawable if the credit could be used within the country where the account was located even though it could not be transferred outside that country. If the currency and the account were otherwise appropriate but the receiving bank did not wish the credit, it should reject the credit (and perhaps the payment order if the payment order had not already been executed) prior to the deadline. It was said that in case of a rejection of the credit prior to the time of payment the right to the funds would automatically revert to the sender and the receiving bank would continue to have a right to be paid in an appropriate manner.

79. It was noted that the Model Rules on the Time of Payment of Monetary Obligations prepared by the Committee on International Monetary Law of the International Law Association provide in pertinent part:

"Rule 1: Basic rule on time of payment"

Payment is deemed to be made at the moment when the amount due is effectively put at the disposal of the creditor.

Rule 2: Payment by bank or giro transfer

Payment by bank or giro transfer, including electronic funds transfer (EFT), is deemed to be made at the moment when the amount due has been unconditionally credited to the creditor's account."

It was also noted that the Model Rules had been drafted to state the time of payment of an obligation that was to be satisfied by a bank transfer and were not necessarily applicable to the satisfaction of an obligation that arose as a part of the transfer.

80. The Working Group decided to adopt the proposal set out in paragraph 70 as modified by the proposal in paragraph 76.

Multilateral netting scheme and central bank credit

81. The Working Group decided to add to the proposal set forth in paragraph 63 a text in respect of the time of payment of a receiving bank that receives payment through a multilateral netting scheme or by central bank credit based on the following:

"(c) If the sender is a bank, when the receiving bank receives final settlement of the obligation with the central bank of the State where the receiving bank is located or through a funds transfer system. If the sender and receiving bank are members of a funds transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with [applicable law and] the rules of the system."

82. It was noted that when the receiving bank receives credit with its own central bank there was no reason for there to be any delay between the time of the credit and the time of payment. It was also noted that the settlement by the central bank had to be final for payment to have occurred. Therefore, if the central bank gave provisional settlement for certain types of transfers, the receiving bank would not be paid until the provisional settlement became final settlement. The Working Group decided not to discuss the question whether the central bank referred to in the provision should be limited by territorial or other connections.

83. The words "applicable law" were intended to indicate that the settlement would have to be final as a matter of law as well as in the manner indicated by the rules of the system. As a result the provision would not purport to validate a netting scheme that might otherwise not be valid under the applicable law. However, a question was raised as to the law of which State was indicated by the reference. Since the Working Group was not yet in a

position to answer that question, the words were placed in square brackets.

Bilateral netting

84. It was noted that in some areas of the world banks often engaged in bilateral netting of payment orders rather than posting the individual payment orders to accounts held by the banks with one another or through accounts in third banks. It was said that the Model Law should provide legal support for such bilateral netting schemes. It was pointed out that in the United States the provision on bilateral netting in article 4A-403(c) had been drafted in such a way as to overcome the common law rule that in order for there to be a setoff, there had to be mutuality of obligations and the parties had to be acting in the same capacity in respect of the claims that were to be setoff.

85. The Working Group agreed to adopt a provision that would provide that if two banks transmit payment orders to each other under an agreement that settlement of the obligations to each other under article 4(4) will be made at the end of the day or other period, each bank as receiving bank is paid when settlement of the net obligation becomes final. At this stage the Model Law would not provide a rule as to the status of the obligations of the two banks prior to the final settlement of the net obligation.

Article 10

Paragraphs (1) and (2)

Irrevocability of a payment order

86. The Working Group discussed whether, as a matter of principle, payment orders under the Model Law should be revocable or irrevocable. It was noted that, since either of those two principles would require a number of exceptions, the two principles would often result in similar practical solutions. However, it was also noted that, despite the similarity in practical solutions, a distinction between the general rule and the exceptions was of importance. It was stated that, under several legal systems, exceptions to a general rule are construed restrictively by the courts. It was also stated that the general rule might determine, in case of litigation, whether the sender of a revocation order or the receiving bank would bear the burden of proof as regards, for example, the time when the revocation order was received.

87. It was noted that the current draft of article 10 was based upon the principle that a payment order was revocable. It was stated that such a rule would not be compatible with the operation of high-speed electronic transfer systems that would, in most cases, execute payment orders within a few seconds after they had received them. In response, the example was given of a large electronic funds transfer system such as the Swiss Interbank Clearing (SIC) that functions even though it admits the revocability of payment orders sent through it. It was also stated that not all payment orders transmitted electronically were executed immediately, particularly in the case of batch processing. As regards the example of batch processing,

however, another view was that attention should be given to the high costs of removing an order from a batch. It was also stated that in many countries credit transfers were still largely paper-based. After discussion, the Working Group decided to base its discussion on a proposed draft of article 10 originally presented at the twentieth session of the Working Group (A/CN.9/329, para. 184) that read as follows:

"Article 10. Payment orders not revocable

(1) A payment order may not be revoked or amended by the sender once it has been received by the receiving bank.

(2) Notwithstanding paragraph (1) a sender may request the assistance of its receiving bank to amend or revoke a payment order and

(a) the receiving bank (other than the beneficiary's bank) may, if it wishes, cooperate with the request of its sender regardless of whether or not it has previously accepted the payment order, except that any request by the receiving bank to amend or revoke its own payment order is subject to this paragraph;

(b) the beneficiary's bank may, if it wishes, cooperate with the request of its sender, provided that it has not accepted the payment order."

88. It was stated that the proposal imposed no duty on the receiving bank to act on a revocation order; the bank had full discretion whether it would cooperate with the sender in trying to stop the execution of the payment order received or in trying to revoke the payment order the bank had issued to its receiving bank. At the same time, by enabling the receiving bank to act, the provision would release the receiving bank from the binding obligations it might have incurred by accepting or executing the payment order before it received the request to revoke. In opposition to the proposal it was said to state the principle of irrevocability of payment orders in too radical a manner. Nevertheless, the Working Group decided that it would state in the Model Law a general principle of irrevocability, which would be subject to limited exceptions.

89. Having adopted the principle of irrevocability, the Working Group considered the point of time when the principle of irrevocability would become applicable. The general view was that, in the case of a receiving bank other than the beneficiary's bank, a payment order should become irrevocable at the latest when it had been executed and, in the case of the beneficiary's bank, when it had been accepted.

90. Another concern was expressed that a bank might receive a revocation order shortly before the time when it executed the payment order or, in the case of the beneficiary's bank, before it accepted the payment order. It was, therefore, decided that the bank should have sufficient time to act pursuant to the revocation order before the payment order became irrevocable.

91. It was stated that execution of a payment order by a receiving bank other than the beneficiary's bank before the execution date (or by the beneficiary's bank before the payment date) should not discharge the bank from the

obligation it might have to act upon receipt of an otherwise timely revocation order.

92. After discussion, it was decided that a revocation order would be effective if it was received in sufficient time before the latest of the time when execution took place and the beginning of the execution date (or payment date, in the case of the beneficiary's bank).

Paragraph (3)

93. The Working Group decided to retain the current text of the paragraph.

Paragraph (4)

94. The Working Group considered whether a receiving bank should have any obligations in regard to a revocation order that was received after the payment order had become irrevocable. It noted that the current text of paragraph (4) provided that a receiving bank other than the beneficiary's bank was obligated to issue a revocation order in respect of its own payment order. After discussion, the Working Group decided that the bank that received a late revocation order could endeavour to revoke its own payment order but would be under no obligation to do so. The Working Group therefore deleted paragraph (4).

Authentication of a revocation order

95. The Working Group noted that the current text of paragraphs (1) and (2) provided that a revocation order was to be authenticated in the same manner as the payment order. It was stated that no reason existed why the parties should be prevented from agreeing that some other authentication procedure would apply, particularly when the revocation order was sent by a different means of communication than the payment order. The Working Group decided that a revocation order would have to be authenticated but not necessarily have to be authenticated in the same manner as the payment order.

Paragraphs (5) and (6)

96. There was general agreement with the principle expressed in paragraph (5) that the sender should not have to pay for the payment order if the revocation order arrived in time to be effective. Some doubt was expressed whether paragraphs (5)(a) and (6) were necessary since the sender would be refunded any payment it had already made to the receiving bank under article 11(b).

97. The Working Group also agreed that, where the revocation order was effective but, nevertheless, the receiving bank executed the payment order and the credit transfer was completed, the receiving bank should have the possibility of recovering the amount paid to the beneficiary to the extent such recovery would be possible under any otherwise applicable doctrine of law. The matter was referred to the Drafting Group.

Paragraphs (8) and (9)

98. The Working Group decided to retain the substance of the paragraphs subject to drafting changes.

Preparation of new text

99. The Working Group noted that a new text of article 10 would be necessary in the light of its decisions and referred the matter to the Drafting Group.

New proposal

100. The Working Group considered a proposal to include a new provision that would read as follows:

"For proper cause and in compliance with applicable law, a court may restrain:

- (a) a person from issuing a payment order to initiate a funds transfer;
- (b) an originator's bank from executing the payment order of the originator, or
- (c) the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing funds.

A court may not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order, or otherwise acting with respect to a credit transfer, but a bank has no obligation if it acts in accordance with the order of a court of competent jurisdiction."

101. In support of the proposal, it was stated that considerable disruption of the banking system might result from the execution of court orders that attempted to affect a credit transfer once the transfer process had been initiated. Therefore, it was considered important to restrict the possibility of executing a court order to the two ends of the credit transfer and to state that no action would be available against an intermediary bank. Although some support was given to the proposal, it was stated that it would be improper for the Model Law to include rules governing judicial procedure. It was also stated that there was no reason why the sender of an unsuccessful revocation order should be prevented from using any means that might be available under the applicable law to stop the execution of the credit transfer. After discussion, the Working Group did not adopt the proposal.

Article 11

102. The Working Group noted that the Drafting Group had under consideration a new draft of article 11 that would significantly change its presentation without changing the substance of the article. However, in order to consider the policy issues presented by the article, it decided to base its discussion on the current text.

103. It was pointed out that subparagraph (a) did not set forth all of the cases in which a receiving bank was obligated to assist the originator or its sender in carrying out a credit transfer. Where the receiving bank itself had failed in one of its obligations by, for example, misdirecting its own payment order, it would be obligated under article 6 to send a new payment order consistent with the order it had received. Subparagraph (a) on the other hand

was directed to the situation where another bank in the credit transfer chain had failed in its obligations and the originator or the sender to the receiving bank requested assistance in respect of that bank.

104. In one view the duty that the subparagraph sought to create was unclear in content and of uncertain utility since no remedy had yet been proposed by which breach of the duty might be appropriately redressed. In reply it was observed that in previous sessions the Working Group had indicated its intention to express a broad, general duty to assist which, even if not specifically enforceable by a clear sanction, would establish a norm for conduct and might, in egregious cases, be enforced by a court's application of general principles of law concerning the breach of a statutory duty.

Subparagraph (b)

105. The view was expressed that the general policy implemented in article 11(b) was inappropriate since it might adversely affect the banking system. It was stated that the duty of the originator's bank to refund to the originator the principal amount of a failed credit transfer was of particular importance in case of the insolvency of an intermediary bank from which the originator's bank had a right of reimbursement. The risk was a new one for banks in certain countries because previously it had been borne by the customers. It was said that the new risk would not be overly burdensome to large banks with foreign branches. Those banks would route most international credit transfers through their branches. It would be the small and middle-sized banks that had to route international credit transfers through correspondent banks in foreign countries that would run the risk. It was said that this would be of particular concern for banks in developing countries.

106. It was also stated that the increased risk for an originator's bank might give rise to new concerns by banking regulators who were increasingly aware of and interested in reducing systemic risk. Examples given raised the possibility of deposit insurance or reserve requirements being changed to address risks such as that which subparagraph (b) sought to create. It was also questioned whether banks might be required to provide capital support for that risk under the Basle Accord. In response, it was stated that at least one country that operated large value funds transfer systems had implemented a rule equivalent to article 11(b) without serious repercussions. The analysis carried out in that country by the bank supervisory authorities had led to the conclusion that the duty to refund to the originator did not raise issues under the Basle Accord, or serious risks of new contingent liabilities threatening the banks.

107. Another view was that the general effect of the Model Law would not be to increase the risks borne by banks. It was said that the effect of bilateral and multi-lateral net settlement agreements, which would be given a certain efficacy by the Model Law (see paragraphs 81 to 85), was estimated to reduce by 50 to 80 per cent the credit risk that otherwise would exist in respect of the transactions.

108. After discussion, the Working Group decided to maintain article 11(b). It requested the Secretariat to send a copy of the present report to the Bank for International Settlements (BIS) for its information. There was a request that delegations specifically prepare for a discussion of the regulatory impact of the new risk at the session of the Commission in June 1991 when the Model Law would be considered, although it was understood by the Working Group that the question of the regulatory impact of bank risk was not within the competence of the Commission.

109. A discussion took place as to whether the provisions of article 11(b) should be mandatory. Under one view the mechanism that guaranteed the sender that he would be refunded in case of an unsuccessful credit transfer was one of the main provisions of the Model Law and parties should not be given the opportunity to derogate from it. Under another view, derogation might be acceptable in special circumstances. For example, where the originator specified that the credit transfer was to be carried out through a particularly unreliable intermediary bank or a particularly unstable country, the originator's bank should have the possibility to conclude a special agreement shifting the responsibility of the transfer to the originator. However, the Model Law should not allow easy derogation, especially by means of a bank's standard terms of dealing. Under yet another view, since the refund mechanism set forth in article 11(b) could be compared to an insurance or guarantee that the credit transfer would be carried out successfully, it would create a cost for the bank for which the bank should be able to charge. An originator might wish to choose a less expensive method of transfer in which the risk that the credit transfer could not be completed and the principal amount of the transfer could not be recovered would be knowingly borne by the originator.

110. After discussion, the Working Group decided that the provisions of article 11(b) would be mandatory, but a receiving bank would not be responsible if refund could not be recovered from another bank (other than the beneficiary's bank) through which the receiving bank was directed to route the transfer. The Drafting Group was requested to prepare a provision to that effect.

111. The Working Group also made certain suggestions as to the content of the provision. It was stated that consideration should be given to the possibility that the funds would be refunded to the originator by a different route from the route used in the failed credit transfer. Another view was that the paragraph should address more clearly the situation where a payment order was issued to a beneficiary's bank in an amount greater than the amount in the payment order issued by the originator to the originator's bank.

Article 15

Paragraph (2)

112. The Working Group noted that, on the proposal of a drafting party, it had already adopted at the current session three paragraphs in place of paragraph (1) and decided that paragraph (2) would be renumbered paragraph (4) (see paragraph 140). A proposal was made to

delete renumbered paragraph (4) on the grounds that, in effect, it created a conflict of laws rule of general application between the originator and the beneficiary. After discussion, the Working Group decided to delete the paragraph. A proposal was made to link the deletion of article 15(4) with the deletion of article 14(2). No support was expressed in favour of that proposal.

Proposed additional paragraphs

113. In addition to the new formulation of paragraphs (1) to (3) as they had already been adopted by the Working Group on the proposal of a drafting party (paragraph 140), the Working Group considered a proposal to add the following paragraphs:

"() Where the rights and obligations referred to in paragraph (1) are embodied in a contract, the second sentence of that paragraph shall not affect the application of any rule of law

(a) for determining which law governs the formal validity of the contract; or

(b) applying the law of another State if it appears from the circumstances as a whole that the contract is more closely connected with that State.

() Paragraph (1) shall not apply to the extent that its application would be manifestly incompatible with the public policy of the forum.

() The application of the law of any State specified by this article means the application of the rules of law in force in that State other than its rules of private international law."

114. It was stated by its proponents that the proposed additional paragraphs were intended to make article 15 compatible with the provisions of the Rome Convention on the Law Applicable to Contractual Obligations. In opposition to the proposal it was said that the Model Law should not aim at accommodating the needs that particular States or groups of States would be facing under any other rule of law or international agreement. After discussion, the proposal was withdrawn by its proponents.

Definition of "execution"

115. The Working Group considered a proposal that "execution" should be defined as follows:

"'Execution' means, with respect to a receiving bank other than the beneficiary's bank, issuance of payment order intended to carry out the payment order received by the receiving bank."

116. It was pointed out that the term was used in many places throughout the Model Law and that it would be useful to have a definition. A discussion took place as to whether this definition of execution should be extended to cover the action taken by the beneficiary's bank. It was said that the beneficiary's bank did not "execute" the payment order but that it could only accept or reject the payment order it received. Once it accepts the payment order, the credit transfer is completed. The Working Group adopted the proposal, and noted that a careful review of

the entire text of the Model Law would be necessary to ensure that all references to "execution" were correct and that all references to "acceptance", "execution date" or "payment date" (with reference to the beneficiary's bank) that might be incompatible with the new definition of "execution" were brought to the attention of the Commission.

Article 9

117. *Execution date.* A suggestion was made that the requirement to execute the payment order on the day it was received might put an excessive burden on the banks. It was also stated that there might exist good reasons why payment orders would not be executed on the day when they had been received, particularly in the case of paper-based payment orders. No support was given to that suggestion.

118. *Paragraph (2).* The Working Group adopted a proposal to amend article 9(2) so as to replace the words "the day the payment order is received" by the words "the date when a payment order is required to be executed under paragraph (1)". In support of that proposal, it was stated that the receiving bank should have no obligation to examine or process payment orders any earlier than they were obliged to in order to give timely notice under the Model Law.

119. *Derogation by contract.* A suggestion was made that the provisions of article 9(1) should be mandatory. It was stated that contractual derogation to those provisions would make it impossible for the originator's banks to predict how long international credit transfers would take when they had to go through several intermediary banks. Although some support was expressed in support of that view, the Working Group decided that the general recognition of the freedom of contract under the Model Law should prevail. Another suggestion was that derogation from the provisions of article 9(1) should be possible only between the originator and the originator's bank. Under yet another view the extent to which the Model Law will place constraints on derogation by parties' contract should be determined in a review of the Model Law as a whole to ensure that it achieves the correct balance between freedom of contract and a reliable core of content in order to be effective legislation.

Article 8

120. A proposal was made to delete article 8(2) and the references to it. In support of that proposal, it was stated that the case might arise where an originator had made a mistake in the indication of the beneficiary's identity that could not be detected by the beneficiary's bank. As an example, it was stated that a payment order might well contain a reference to an account number as the only indication of the beneficiary's identity. It was stated that, in such a situation, the banking system should bear no liability to the originator. It was also noted that as a technical matter, the definition of "beneficiary's bank" made it impossible for a payment order received by it to

be misdirected. After discussion, the Working Group deleted the paragraph.

Article 4

121. At the twenty-first session of the Working Group the Secretariat was requested to propose a provision governing the use by a receiving bank of an error detection procedure. The proposal of the Secretariat was considered by a small group and a revised proposal for a new paragraph (3 *bis*) was submitted to the Working Group. The proposal read as follows:

"A sender who is bound by a payment order is bound by the terms of the order as received by the receiving bank. However, if the sender and the receiving bank have agreed upon a procedure for detecting erroneous duplicates or errors in a payment order, the sender is not bound by the payment order if [the sender complied with the procedure and] use of the procedure by the receiving bank revealed or would have revealed the erroneous duplicate or the error. If the error which the bank would have detected was that the sender instructed payment of an amount greater than the amount intended by the sender, the sender shall be bound only to the extent of the amount that was intended."

122. It was recalled that some procedures used in respect of the identification of the sender depended upon the use of an algorithm that incorporated the contents of the payment order. In those cases, any error in the content of the payment order would cause the authentication to fail. In other cases a payment order might have an authentication procedure that did not depend on the content of the payment order. In those cases a separate procedure for the detection of errors might be employed. The proposed provision was designed for those situations.

123. It was also recalled that, at its twentieth session, the Working Group had not accepted a suggestion to define "authentication" to cover both identification of source of a message and detection of errors in the message (A/CN.9/329, paras. 77 to 79).

124. A view was expressed that explicitly requiring compliance by the sender with any agreed upon procedure was necessary to protect the rights of a receiving bank in the event of an erroneous payment order. After discussion the Working Group decided that the procedure envisaged in the proposal should not depend on whether the sender complied with any aspect of an agreed upon procedure. If it had not and that made it impossible for the receiving bank to exercise the error detection procedure agreed upon, the sender would bear the risk that an error would not be found.

125. A concern was expressed as to the general policy that a sender should be bound by the payment order as it was received. It was stated that the Model Law did not clearly state the moment when a payment order was received. The example was given of a payment order that would be transmitted through an automatic teller machine controlled by the receiver and corrupted at a later stage during its transmission to the receiving bank's central

computer. It was stated that, in such a situation, the sender should not have to bear the consequences of the error. It was therefore proposed to add the following words at the end of the first sentence of the proposal:

"unless a sender proves that the terms of the payment order issued by the sender are different from the terms of the payment order received by the receiving bank and that the change of the terms occurred during the transmission process of the payment order under the control of the receiving bank and without any fault of the sender."

126. The Working Group did not reconsider its policy decision that the sender would be bound by the terms of the payment order as received by the receiving bank. After discussion, the Working Group adopted the proposal stated in paragraph 121, deleting the words in square brackets.

II. DRAFTING CHANGES IN THE MODEL LAW

127. The Working Group considered the other drafting proposals made by the drafting party. It was noted that these proposals carried no implication as to the substance of the Model Law.

128. The Working Group noted that, at its twenty-first session, it had made a number of policy decisions and requested the Secretariat to propose new draft provisions to implement those decisions. Those drafting proposals were set out in A/CN.9/WG.IV/WP.49. At its current session, the Working Group requested a small drafting party to review those provisions and make appropriate changes. After discussion on the report of the drafting party, the Working Group adopted the provisions set forth in paragraphs 129 to 141.

Article 1

129. The footnote was redrafted as follows:

"*This law does not deal with issues related to the protection of consumers."

Article 2(b)

130. Subparagraph (iii) was replaced by the following:

"the instruction does not provide that payment is to be made at the request of the beneficiary."

131. A concern was expressed that the wording may not be sufficiently clear as to exclude point-of-sale payment transactions.

132. The following additional words to the definition of "payment order" were accepted in principle with an expectation that they would be reformulated by the Drafting Group:

"Where an instruction is not a payment order because it is issued subject to a condition, and the condition is

subsequently satisfied, the instruction shall be treated as if it had been unconditional when it was issued; but this shall not affect the rights or obligations of any person in respect of the instruction during the period before the condition was satisfied."

Article 2(f)

133. As requested, the Secretariat suggested a word to be used in place of "bank". The term suggested was "credit transfer institution". The Working Group decided that the term "bank" would continue to be used.

134. It was decided that the following new sentence would be added at the end of the definition:

"An entity is not to be taken as executing payment orders merely because it transmits them."

Definition of "branch"

135. In place of the proposal to define the word "branch" of a bank as used in articles 1(2), 6(7), 9(5) and 10(9), the Working Group decided that the words "and separate offices" would be added following the word "branch" in those provisions.

Article 4(2)

136. The Working Group added the following sentence:

"The parties may not agree that this paragraph shall apply if the method of authentication is not commercially reasonable."

Article 12(4)

137. The Working Group decided that subparagraph (a) should read as follows:

"The beneficiary's bank is liable

(a) to the beneficiary, to the extent provided by the law governing the relationship between the beneficiary and the bank, for its failure to perform one of its obligations under article 8(1) and (6), and"

Article 14

138. The Working Group decided that the title of chapter IV and of article 14 would be changed to

"Completion of credit transfer and discharge of obligation"

139. The Working Group further decided that paragraph (2 *bis*) would be renumbered paragraph (1) and that a new paragraph (3) would read as follows:

"A credit transfer shall be considered complete notwithstanding that the amount of the payment order accepted by the beneficiary's bank is less than the amount of the originator's payment order because one or more receiving banks have deducted charges. The completion of the credit transfer shall not prejudice any

right of the beneficiary under the applicable law to recover the amount of those charges from the originator."

Article 15

140. The Working Group adopted the following three paragraphs in place of paragraph (1) and decided that paragraph (2) would be renumbered paragraph (4):

"(1) The rights and obligations arising out of a payment order shall be governed by the law chosen by the parties. In the absence of agreement, the law of the State of the receiving bank shall apply.

(2) The second sentence of paragraph (1) shall not affect the determination of which law governs the question whether the actual sender of the payment order had the authority to bind the purported sender for the purposes of article 4(1).

(3) For the purposes of this article

(a) where a State comprises several territorial units having different rules of law each territorial unit shall be considered to be a separate State, and

(b) branches and separate offices of a bank in different States shall be considered to be separate banks."

Article 16

141. The Working Group decided that the article would be moved to article 3 (which currently was deleted) and that it would be given the title "Variation by agreement".

III. DRAFTING GROUP AND ADOPTION OF DRAFT MODEL LAW

142. A Drafting Group was created and was charged with the review of the entire text of the draft Model Law to assure proper style, to eliminate inconsistencies and to assure the concordance of the six language versions. The text of the draft Model Law was adopted by the Working Group on the recommendation of the Drafting Group and is presented to the Commission for its consideration. The text of the draft Model Law as adopted by the Working Group is reproduced in the annex to this report.

ANNEX

*Draft UNCITRAL Model Law on International Credit Transfers**

CHAPTER I. GENERAL PROVISIONS

Article 1. *Sphere of application**

(1) This law applies to credit transfers where a sending bank and its receiving bank are in different States.

*This law does not deal with issues related to the protection of consumers.

*Text of the draft Model Law as adopted by the Working Group on International Payments at its twenty-second session, on 7 December 1990.

(2) For the purpose of determining the sphere of application of this law, branches and separate offices of a bank in different States are separate banks.

Article 2. *Definitions*

For the purposes of this law:

(a) "Credit transfer" means the series of operations, beginning with the originator's payment order, made for the purpose of placing funds at the disposal of a beneficiary. The term includes any payment order issued by the originator's bank or any intermediary bank intended to carry out the originator's payment order. [The term does not include a transfer effected through a point-of-sale payment system.]

(b) "Payment order" means an unconditional instruction by a sender to a receiving bank to place at the disposal of a beneficiary a fixed or determinable amount of money if:

(i) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and

(ii) the instruction does not provide that payment is to be made at the request of the beneficiary.

When an instruction is not a payment order because it is issued subject to a condition but the condition is subsequently satisfied and thereafter a bank that has received the instruction executes it, the instruction shall be treated as if it had been unconditional when it was issued.

(c) "Originator" means the issuer of the first payment order in a credit transfer.

(d) "Beneficiary" means the person designated in the originator's payment order to receive funds as a result of the credit transfer.

(e) "Sender" means the person who issues a payment order, including the originator and any sending bank.

(f) "Bank" means an entity which, as an ordinary part of its business, engages in executing payment orders. An entity is not to be taken as executing payment orders merely because it transmits them.

(g) A "receiving bank" is a bank that receives a payment order.

(h) "Intermediary bank" means any receiving bank other than the originator's bank and the beneficiary's bank.

(i) "Funds" or "money" includes credit in an account kept by a bank and includes credit denominated in a monetary unit of account that is established by an intergovernmental institution or by agreement of two or more States, provided that this law shall apply without prejudice to the rules of the intergovernmental institution or the stipulations of the agreement.

(j) "Authentication" means a procedure established by agreement to determine whether all or part of a payment order or a revocation of a payment order was issued by the purported sender.

(k) "Execution date" means the date when the receiving bank should execute the payment order in accordance with article 10.

(l) "Execution" means, with respect to a receiving bank other than the beneficiary's bank, the issue of a payment order intended to carry out the payment order received by the receiving bank.

(m) "Payment date" means the date specified in the payment order when the funds are to be placed at the disposal of the beneficiary.

Article 3. *Variation by agreement*

Except as otherwise provided in this law, the rights and obligations of a party to a credit transfer may be varied by agreement of the affected party.

CHAPTER II. DUTIES OF THE PARTIES

Article 4. *Obligations of sender*

(1) A purported sender is bound by a payment order or a revocation of a payment order if it was issued by him or by another person who had the authority to bind the purported sender.

(2) When a payment order is subject to authentication, a purported sender who is not bound under paragraph (1) is nevertheless bound if:

(a) the authentication provided is a commercially reasonable method of security against unauthorized payment orders, and

(b) the receiving bank complied with the authentication.

(3) The parties are not permitted to agree that paragraph (2) shall apply if the authentication is not commercially reasonable.

(4) A purported sender is, however, not bound under paragraph (2) if it proves that the payment order as received by the receiving bank resulted from the actions of a person other than a present or former employee of the purported sender, unless the receiving bank is able to prove that the payment order resulted from the actions of a person who had gained access to the authentication procedure through the fault of the purported sender.

(5) A sender who is bound by a payment order is bound by the terms of the order as received by the receiving bank. However, if the sender and the receiving bank have agreed upon a procedure for detecting erroneous duplicates or errors in a payment order, the sender is not bound by the payment order if use of the procedure by the receiving bank revealed or would have revealed the erroneous duplicate or the error. If the error that the bank would have detected was that the sender instructed payment of an amount greater than the amount intended by the sender, the sender shall be bound only to the extent of the amount that was intended.

(6) A sender becomes obligated to pay the receiving bank for the payment order when the receiving bank accepts it, but payment is not due until the [execution date], unless otherwise agreed.

Article 5. *Payment to receiving bank*

Payment of the sender's obligation under article 4(6) to pay the receiving bank occurs:

(a) if the receiving bank debits an account of the sender with the receiving bank, when the debit is made; or

(b) if the sender is a bank and subparagraph (a) does not apply,

(i) when a credit that the sender causes to be entered to an account of the receiving bank with the sender is used or, if not used, on the business day following the day on which the credit is available for use and the receiving bank learns of that fact, or

(ii) when a credit that the sender causes to be entered to an account of the receiving bank in another bank is used or, if not used, on the business day following

the day on which the credit is available for use and the receiving bank learns of that fact, or

(iii) when final settlement is made in favour of the receiving bank at the central bank of the State where the receiving bank is located, or

(iv) when final settlement is made in favour of the receiving bank

a. through a funds transfer system that provides for the settlement of obligations among participants either bilaterally or multilaterally and the settlement is made in accordance with applicable law and the rules of the system, or

b. in accordance with a bilateral netting agreement with the sender; or

(c) if neither subparagraph (a) nor (b) applies, as otherwise provided by law.

Article 6. *Acceptance or rejection of a payment order by receiving bank that is not the beneficiary's bank*

(1) The provisions of this article apply to a receiving bank that is not the beneficiary's bank.

(2) A receiving bank accepts the sender's payment order at the earliest of the following times:

(a) when the time for execution under article 10 has elapsed without notice of rejection having been given, provided that: (i) where payment is to be made by debiting an account of the sender with the receiving bank, acceptance shall not occur until there are funds available in the account to be debited sufficient to cover the amount of the payment order; or (ii) where payment is to be made by other means, acceptance shall not occur until the receiving bank has received payment from the sender in accordance with article 5(b) or (c),

(b) when the bank receives the payment order, provided that the sender and the bank have agreed that the bank will execute payment orders from the sender upon receipt,

(c) when it gives notice to the sender of acceptance, or

(d) when it issues a payment order intended to carry out the payment order received.

(3) A receiving bank that does not accept a sender's payment order, otherwise than by virtue of subparagraph (2)(a), is required to give notice to that sender of the rejection, unless there is insufficient information to identify the sender. A notice of rejection of a payment order must be given not later than on the execution date.

Article 7. *Obligations of receiving bank that is not the beneficiary's bank*

(1) The provisions of this article apply to a receiving bank that is not the beneficiary's bank.

(2) A receiving bank that accepts a payment order is obligated under that payment order to issue a payment order, within the time required by article 10, either to the beneficiary's bank or to an appropriate intermediary bank, that is consistent with the contents of the payment order received by the receiving bank and that contains the instructions necessary to implement the credit transfer in an appropriate manner.

(3) When a payment order is received that contains information which indicates that it has been misdirected and which contains sufficient information to identify the sender, the receiving bank shall give notice to the sender of the misdirection, within the time required by article 10.

(4) When an instruction does not contain sufficient data to be a payment order, or being a payment order it cannot be executed because of insufficient data, but the sender can be identified, the receiving bank shall give notice to the sender of the insufficiency, within the time required by article 10.

(5) If there is an inconsistency in a payment order between the words and figures that describe the amount of money, the receiving bank shall, within the time required by article 10, give notice to the sender of the inconsistency, if the sender can be identified. This paragraph does not apply if the sender and the bank have agreed that the bank would rely upon either the words or the figures, as the case may be.

(6) The receiving bank is not bound to follow an instruction of the sender specifying an intermediary bank, funds transfer system or means of transmission to be used in carrying out the credit transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would cause excessive costs or delay in completion of the credit transfer. The receiving bank acts within the time required by article 10 if, in the time required by that article, it enquires of the sender as to the further actions it should take in light of the circumstances.

(7) For the purposes of this article, branches and separate offices of a bank, even if located in the same State, are separate banks.

Article 8. *Acceptance or rejection by beneficiary's bank*

(1) The beneficiary's bank accepts a payment order at the earliest of the following times:

(a) when the time for [execution] under article 10 has elapsed without notice of rejection having been given, provided that: (i) where payment is to be made by debiting an account of the sender with the beneficiary's bank, acceptance shall not occur until there are funds available in the account to be debited sufficient to cover the amount of the payment order; or (ii) where payment is to be made by other means, acceptance shall not occur until the beneficiary's bank has received payment from the sender in accordance with article 5(b) or (c),

(b) when the bank receives the payment order, provided that the sender and the bank have agreed that the bank will [execute] payment orders from the sender upon receipt,

(c) when it notifies the sender of acceptance,

(d) when the bank credits the beneficiary's account or otherwise places the funds at the disposal of the beneficiary,

(e) when the bank gives notice to the beneficiary that it has the right to withdraw the funds or use the credit,

(f) when the bank otherwise applies the credit as instructed in the payment order,

(g) when the bank applies the credit to a debt of the beneficiary owed to it or applies it in conformity with an order of a court.

(2) A beneficiary's bank that does not accept a sender's payment order, otherwise than by virtue of subparagraph (1)(a), is required to give notice to the sender of the rejection, unless there is insufficient information to identify the sender. A notice of rejection of a payment order must be given not later than on the [execution date].

Article 9. *Obligations of beneficiary's bank*

(1) The beneficiary's bank is, upon acceptance of a payment order received, obligated to place the funds at the disposal of the

beneficiary in accordance with the payment order and the applicable law governing the relationship between the bank and the beneficiary.

(2) When an instruction does not contain sufficient data to be a payment order, or being a payment order it cannot be [executed] because of insufficient data, but the sender can be identified, the beneficiary's bank shall give notice to the sender of the insufficiency, within the time required by article 10.

(3) If there is an inconsistency in a payment order between the words and figures that describe the amount of money, the beneficiary's bank shall, within the time required by article 10, give notice to the sender of the inconsistency, if the sender can be identified. This paragraph does not apply if the sender and the bank have agreed that the bank would rely upon either the words or the figures, as the case may be.

(4) Where the beneficiary is described by both words and figures, and the intended beneficiary is not identifiable with reasonable certainty, the beneficiary's bank shall give notice, within the time required by article 10, to its sender and to the originator's bank, if they can be identified.

(5) The beneficiary's bank shall on the [execution date] give notice to a beneficiary who does not maintain an account at the bank that it is holding funds for his benefit, if the bank has sufficient information to give such notice.

Article 10. *Time for receiving bank to [execute] payment order and give notices*

(1) A receiving bank is required to [execute] the payment order on the day it is received, unless

(a) a later date is specified in the order, in which case the order shall be [executed] on that date, or

(b) the order specifies a payment date and that date indicates that later execution is appropriate in order for the beneficiary's bank to accept a payment order and place the funds at the disposal of the beneficiary on the payment date.

(2) A notice required to be given under article 7(3), (4) or (5) shall be given on or before the day the payment order is required to be executed.

(3) A notice required to be given under article 9(2), (3) or (4) shall be given on or before the [payment date].

(4) A receiving bank that receives a payment order after the receiving bank's cut-off time for that type of payment order is entitled to treat the order as having been received on the following day the bank [executes] that type of payment order.

(5) If a receiving bank is required to take an action on a day when it is not open for the [execution] of payment orders of the type in question, it must take the required action on the following day it [executes] that type of payment order.

(6) For the purposes of this article, branches and separate offices of a bank, even if located in the same State, are separate banks.

Article 11. *Revocation*

(1) A payment order may not be revoked by the sender unless the revocation order is received by a receiving bank other than the beneficiary's bank at a time and in a manner sufficient to afford the receiving bank a reasonable opportunity to act before the later of the actual time of execution and the beginning of the execution date.

(2) A payment order may not be revoked by the sender unless the revocation order is received by the beneficiary's bank at a time and in a manner sufficient to afford the bank a reasonable opportunity to act before the later of the time it accepts the payment order or the beginning of the payment date.

(3) Notwithstanding the provisions of paragraphs (1) and (2), the sender and the receiving bank may agree that payment orders issued by the sender to the receiving bank are to be irrevocable or that a revocation order is effective only if it is received by an earlier point of time than provided in paragraphs (1) and (2).

(4) A revocation order must be authenticated.

(5) A receiving bank other than the beneficiary's bank that executes or a beneficiary's bank that accepts a payment order that has been revoked is not entitled to payment for that payment order and, if the credit transfer is completed in accordance with article 17(1), shall refund any payment received by it.

(6) If the recipient of a refund under paragraph (5) is not the originator of the transfer, it shall pass on the refund to the previous sender.

(7) If the credit transfer is completed in accordance with article 17(1) but a receiving bank [executed] a revoked payment order, the receiving bank has such rights to recover from the beneficiary the amount of the credit transfer as are otherwise provided by law.

(8) The death, bankruptcy, or incapacity of either the sender or the originator does not of itself, operate to revoke a payment order or terminate the authority of the sender. The word "bankruptcy" includes all forms of personal, corporate and other insolvency.

(9) For the purposes of this article, branches and separate offices of a bank, even if located in the same State, are separate banks.

CHAPTER III. CONSEQUENCES OF FAILED, ERRONEOUS OR DELAYED CREDIT TRANSFERS

Article 12. *Duty to assist*

If the credit transfer is not completed in accordance with article 17(1), each receiving bank is obligated to assist the originator and each subsequent sending bank, and to seek the assistance of the next receiving bank, in completing the credit transfer.

Article 13. *Duty to refund*

(1) If the credit transfer is not completed in accordance with article 17(1), the originator's bank is obligated to refund to the originator any payment received from it, with interest from the day of payment to the day of refund. The originator's bank and each subsequent receiving bank is entitled to the return of any funds it has paid to its receiving bank, with interest from the day of payment to the day of refund.

(2) The provisions of paragraph (1) may not be varied by agreement. However, a receiving bank shall not be required to make a refund under paragraph (1) if it is unable to obtain a refund because an intermediary bank through which it was directed to effect the credit transfer has suspended payment or is prevented by law from making the refund. The sender that first specified the use of that intermediary bank shall have the right to obtain the refund from the intermediary bank.

Article 14. *Correction of underpayment*

If the credit transfer is completed in accordance with article 17(1), but the amount of the payment order executed by a receiving bank is less than the amount of the payment order it accepted, it is obligated to issue a payment order for the difference between the amounts of the payment orders.

Article 15. *Restitution of overpayment*

If the credit transfer is completed in accordance with article 17(1), but the amount of the payment order executed by a receiving bank is greater than the amount of the payment order it accepted, it has such rights to recover from the beneficiary the difference between the amounts of the payment orders as are otherwise provided by law.

Article 16. *Liability and damages*

(1) A receiving bank other than the beneficiary's bank is liable to the beneficiary for its failure to execute its sender's payment order in the time required by article 10(1), if the credit transfer is completed under article 17(1). The liability of the receiving bank shall be to pay interest on the amount of the payment order for the period of delay caused by the receiving bank's failure. Such liability may be discharged by payment to its receiving bank or by direct payment to the beneficiary.

(2) If a receiving bank that is the recipient of interest under paragraph (1) is not the beneficiary of the transfer, the receiving bank shall pass on the benefit of the interest to the next receiving bank or, if it is the beneficiary's bank, to the beneficiary.

(3) A receiving bank other than the beneficiary's bank that does not give a notice required under article 7(3), (4) or (5) shall pay interest to the sender on any payment that it has received from the sender under article 4(6) for the period during which it retains the payment.

(4) A beneficiary's bank that does not give a notice required under article 9(2) or (3) shall pay interest to the sender on any payment that it has received from the sender under article 4(6), from the day of payment until the day that it provides the required notice.

(5) A receiving bank that issues a payment order in an amount less than the amount of the payment order it accepted shall, if the credit transfer is completed under article 17(1), be liable to the beneficiary for interest on any part of the difference that is not placed at the disposal of the beneficiary on the payment date, for the period of time after the payment date until the full amount is placed at the disposal of the beneficiary. This liability applies only to the extent that the late payment is caused by the receiving bank's improper action.

(6) The beneficiary's bank is liable to the beneficiary to the extent provided by the law governing the relationship between the beneficiary and the bank for its failure to perform one of the obligations under article 9(1) or (5).

(7) The provisions of this article may be varied by agreement to the extent that the liability of one bank to another bank is increased or reduced. Such an agreement to reduce liability may be contained in a bank's standard terms of dealing. A bank may agree to increase its liability to an originator or beneficiary that is not a bank, but may not reduce its liability to such an originator or beneficiary.

(8) The remedies provided in this law do not depend on the existence of a pre-existing relationship between the parties,

whether contractual or otherwise. These remedies shall be exclusive, and no other remedy arising out of other doctrines of law shall be available except any remedy that may exist when a bank has improperly executed a payment order or failed to execute a payment order (a) with the intent to cause loss, or (b) recklessly and with knowledge that loss might result.

CHAPTER IV. COMPLETION OF CREDIT TRANSFER AND DISCHARGE OF OBLIGATION

Article 17. *Completion of credit transfer and discharge of obligation*

(1) A credit transfer is completed when the beneficiary's bank accepts the payment order. When the credit transfer is completed, the beneficiary's bank becomes indebted to the beneficiary to the extent of the payment order accepted by it.

(2) If the transfer was for the purpose of discharging an obligation of the originator to the beneficiary that can be discharged by credit transfer to the account indicated by the originator, the obligation is discharged when the beneficiary's bank accepts the payment order and to the extent that it would be discharged by payment of the same amount in cash.

(3) A credit transfer shall be considered complete notwithstanding that the amount of the payment order accepted by the

beneficiary's bank is less than the amount of the originator's payment order because one or more receiving banks have deducted charges. The completion of the credit transfer shall not prejudice any right of the beneficiary under the applicable law to recover the amount of those charges from the originator.

CHAPTER V. CONFLICT OF LAWS

Article 18. *Conflict of laws*

(1) The rights and obligations arising out of a payment order shall be governed by the law chosen by the parties. In the absence of agreement, the law of the State of the receiving bank shall apply.

(2) The second sentence of paragraph (1) shall not affect the determination of which law governs the question whether the actual sender of the payment order had the authority to bind the purported sender for the purposes of article 4(1).

(3) For the purposes of this article,

(a) where a State comprises several territorial units having different rules of law, each territorial unit shall be considered to be a separate State, and

(b) branches and separate offices of a bank in different States are separate banks.

F. Working paper submitted to the Working Group on International Payments at its twenty-second session: international credit transfers: comments on the draft Model Law on International Credit Transfers: report of the Secretary-General (A/CN.9/WG.IV/WP.49) [Original: English]

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INTRODUCTION

1. The Commission, in conjunction with its decision at the nineteenth session in 1986 to authorize the Secretariat to publish the UNCITRAL Legal Guide on Electronic Funds Transfers (A/CN.9/SER.B/1) as a product of the work of the Secretariat, decided to begin the preparation of model rules on electronic funds transfers and to entrust the task to the Working Group on International Payments (A/41/17, para. 230).

2. The Working Group undertook the task at its sixteenth session held at Vienna from 2 to 13 November 1987 at which it considered a number of legal issues set forth in a report prepared by the Secretariat (A/CN.9/WG.IV/WP.35). At the conclusion of the session the Working Group requested the Secretariat to prepare draft provisions based on the discussions during that session for its consideration at its next meeting (A/CN.9/297, para. 98).

3. At its seventeenth session held in New York from 5 to 15 July 1988 the Working Group considered a text of the draft provisions prepared by the Secretariat (A/CN.9/WG.IV/WP.37). At the close of the session the Working Group requested the Secretariat to prepare a revised draft of the provisions (A/CN.9/317, para. 10).

4. At its eighteenth session held at Vienna from 5 to 16 December 1988 the Working Group began its consideration of the redraft of the Model Rules prepared by the Secretariat in A/CN.9/WG.IV/WP.39. It renamed the draft Model Rules as the draft Model Law on International Credit Transfers (A/CN.9/318). The Working Group continued its consideration of the draft provisions at its nineteenth session held in New York from 10 to 21 July 1989. During the session a drafting group prepared a restructured text of the draft Model Law (A/CN.9/328, annex I). The restructured text was discussed at the twentieth session of the Working Group held at Vienna from 27 November to 6 December 1989. A drafting group revised articles 1 to 9 of the draft Model Law but left articles 10 to 15 unchanged (A/CN.9/329, annex). The Working Group continued its discussion of the draft Model Law at its twenty-first session held in New York from 9 to 20 July 1990 where a certain number of changes in the text were adopted. In a number of other cases the Working Group decided that the draft Model Law should be changed to reflect a certain policy decision, but did not adopt a

specific text to reflect that decision. All such policy decisions, as well as a few made at prior sessions of the Working Group, were reflected in footnotes to the draft Model Law as it appeared in the annex to the report of the twenty-first session (A/CN.9/341, annex).

5. This report contains a commentary on the draft articles of the text as it emerged from the twenty-first session of the Working Group (A/CN.9/341, annex), indicating their history and their relationship to other provisions. Where the commentary is historical, where the text of an article was not considered at the twenty-first session, or the text of an article was considered but not changed, the commentary is often identical to that in A/CN.9/WG.IV/WP.46. The report also contains suggested texts to implement the policy decisions that have been made by the Working Group.

6. A new feature of this report is that it provides references to the relevant provisions in Article 4A of the Uniform Commercial Code of the United States for comparison. Article 4A governs the same kinds of credit transfers as does the draft Model Law, except that Article 4A is not limited either to domestic or to international credit transfers. Its preparation began in the United States somewhat before the beginning of the preparation of the Model Law.

7. The principal interest in Article 4A arises out of the fact that it is the only legislative text in existence that provides a basic legal structure for credit transfers. In all other States, including those States where credit transfers have been the principal means of interbank payments, the law of credit transfers is derived from a multitude of sources. As a result, the draft of Article 4A that was current at the time of a meeting of the Working Group has often been a source of ideas for the consideration of the Working Group.

8. The final text of Article 4A was adopted by its sponsoring organizations in August 1989 and soon thereafter was presented to the individual states within the United States for adoption. It has been adopted by a number of those states, including the state of New York, where the Clearing House Interbank Payments System (CHIPS) is located. It will also govern the operations of the Federal Reserve System wire transfer network (FEDWIRE) once the proposed Regulation J is adopted.

9. Summary comparisons between the Model Law and Article 4A are often difficult because of the differences in the structure and in the drafting style of the two texts. Article 4A often goes beyond the enunciation of a general rule, as does the draft Model Law, by providing for a number of detailed implementing sub-rules and by providing for many of the more important exceptions to the general rule. These implementing sub-rules and exceptions are often important. Furthermore, the complexity of the text, often brought about by the level of detail contained in it, has led to extensive explicit and implicit cross-referencing. Since the full context of the Article 4A rules cannot be set out in the summary comparisons stated in this report, the interested reader should turn to the full text of Article 4A itself.

COMMENTS ON THE DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS

Title of the Model Law

Prior discussion

A/CN.9/318, paras. 10 to 19
A/CN.9/329, paras. 11 to 15

Comments

1. The current title was adopted by the Working Group at its eighteenth session. The Working Group decided that the words "Model Law" should be used in the title to reflect the fact that the text was for use by national legislators and that the text should not for the time being be in the form of a convention (A/CN.9/318, paras. 12 and 13).
2. The use of the words "Credit Transfers" reflected the decision that only credit transfers and not debit transfers should be included (A/CN.9/318, para. 14). The decision is set forth as a rule in article 1(1). Credit transfers are defined in article 2(a).
3. The word "electronic" is not used in the title as a result of the decision that the Model Law would be applicable to paper-based credit transfers as well as to those made by electronic means (A/CN.9/318, paras. 15 to 17). At the twenty-first session, while no suggestion was made that the Model Law should not apply to paper-based credit transfers, there was general agreement that the Model Law should be drafted so as to meet the operating needs of high speed electronic credit transfers (A/CN.9/341, para. 28; see also paras. 24 to 27 and 56).
4. The Working Group at the eighteenth session decided that the Model Law should be restricted to international credit transfers and that that decision should be reflected in the title (A/CN.9/318, para. 18). At its twentieth session the Working Group reaffirmed its decision to restrict the sphere of application of the Model Law to international credit transfers (A/CN.9/329, paras. 12 to 15). It noted that the preparation of a model law applicable to domestic as well as international credit transfers was within its mandate. However, it also noted that there were differences between the two types of transfers that justified different

treatment of some of the legal issues that arose. Furthermore, appropriate solutions might not be the same in all States for domestic credit transfers. As a result it was believed to be preferable not to confront the difficult political problems that might be created by providing in the Model Law that it applied to all credit transfers. Nevertheless, some States might wish to apply the Model Law to both domestic and international credit transfers.

5. The criteria for determining whether a credit transfer is international are to be found in article 1.

Comparison with Article 4A

6. The title of Article 4A, "Funds transfers", and the definition of that term in Article 4A-104, are an indication that in the greatest respect the substantive spheres of application are almost identical. Although Article 4A was prepared because of the recent development of high-speed high-value credit transfers in the United States, it would apply to transfers made by any technology. For example, Article 4A-302(a)(2) anticipates the execution of a payment order "by first class mail" under certain circumstances. However, since there has never been an interbank paper-based credit transfer system in the United States, and since the credit transfer system based on the bulk exchange of payment orders, especially by the physical exchange of magnetic tapes and similar devices, is of comparatively minor importance, the substantive rules are oriented towards the exchange of individual high-speed high-value payment orders.

CHAPTER I. GENERAL PROVISIONS

*Article 1. Sphere of application**

- (1) This Law applies to a credit transfer where a sending bank and its receiving bank are in different States.
- (2) For the purpose of determining the sphere of application of this Law, branches of a bank in different States are considered to be separate banks.

*This law is subject to any national legislation dealing with the rights and obligations of consumers.

Prior discussion

A/CN.9/297, paras. 12 to 23 and 29 to 31
A/CN.9/317, paras. 16 to 24, 30 and 95 to 97
A/CN.9/318, paras. 20 to 34, 53 and 54
A/CN.9/329, paras. 12 to 25 and 194
A/CN.9/341, paras. 57 to 65

Error in A/CN.9/341, annex

The footnote to article 1 as set out in A/CN.9/341, annex refers to "this Model Law".

Comments

1. The general scope of article 1 was adopted by the Working Group at its eighteenth session (A/CN.9/318). It

was reconsidered at the twentieth and twenty-first sessions, where several amendments were adopted (A/CN.9/329 and A/CN.9/341).

Internationality of a transfer

2. As indicated by the title, the Model Law will apply only to credit transfers that are international. However, at the twentieth session the Working Group noted that some States might wish to apply the Model Law to both domestic and international transfers (A/CN.9/329, para. 14).

3. The test of internationality in paragraph (1) as it was adopted at the eighteenth session was that the originator's bank and the beneficiary's bank were in different countries. The Working Group decided at its twentieth session to eliminate the result pointed out in A/CN.9/WG.IV/WP.44, article 1, comments 4 to 6 that, since a bank that originated a credit transfer for its own account was an originator and not an originator's bank, a transfer by such a bank to a second bank through a mutual correspondent bank would not fall within the sphere of application of the Model Law even if all three banks were in different States. In order to carry out its decision, the Working Group decided to add the words "or, if the originator is a bank, that bank and its receiving bank are in different countries" (A/CN.9/329, paras. 16 to 23). The formulation was changed by the drafting group, a result that the Working Group disavowed during the adoption of the report of the twentieth session but did not correct for lack of time (A/CN.9/329, para. 194). At the twenty-first session the Working Group began by returning to the original formula (A/CN.9/341, para. 58). After discussion it adopted the current text of paragraph (1) (A/CN.9/341, para. 64).

4. The current formula requires that any one sending bank and its receiving bank in the chain of sending and receiving banks that carry out the credit transfer must be in different States. If any such pair of sending and receiving banks is located in two States, the credit transfer is international and the Model Law applies to every segment in the chain. This is so even though a particular segment is between a sender (originator or sending bank) and a receiving bank in the same State. Except for the originator's bank, the first receiving bank in every State involved in a particular credit transfer necessarily receives a payment order from a sending bank in another State. However, the originator, the originator's bank as well as the next several receiving banks in the credit transfer chain may be in the same State. All of the payment orders between these parties are subject to the Model Law even though they are prior to the sending of a payment order from a sending bank in that State to a receiving bank in another State.

5. Since paragraph (1) refers only to the location of a sending bank and a receiving bank, the location of a non-bank sender is irrelevant for determining whether the credit transfer is international. Therefore, when a non-bank originator resident in State A issues a payment order to the originator's bank in State B instructing a transfer to the account of the beneficiary at the same or a different bank in State B, the credit transfer would not be international. However, if the originator resident in State A was

a bank, its payment order to its bank in State B would be between banks in different States and the credit transfer would be international.

6. In some cases in which a transfer is made from a customer's account in a financial institution in State A to an account in a financial institution in State B, the sending financial institution may not be considered to be a bank under the definition of a bank in article 2(f). Such a situation might arise where the sending financial institution was a broker which would, on instructions of a customer, transfer a credit balance in a customer's brokerage account, but which did not engage in executing payment orders as an ordinary part of its business. See comment 30 to article 2. In that case the sending financial institution would not be a bank. A similar situation arises when the receiving financial institution in State B is not a bank and the payment order issued to it is the only payment order to go from one State to another. In either of those situations the Model Law would not apply. At the twenty-first session of the Working Group the definition of a "bank" in article 2(f) was modified so as to increase the likelihood that an entity that held accounts of its customers that were subject to payment orders would be considered to be a bank. See comment 33 to article 2.

7. A transfer may be international even though the originator's bank and the beneficiary's bank are in the same State. That situation can occur when a transfer between an originator's bank and a beneficiary's bank, both of which are in State A, is denominated in the currency of State B. In such a case the originator's bank would often send a payment order to its correspondent bank in State B instructing it to credit the account of the beneficiary's bank, or instructing it to send a payment order to the correspondent bank of the beneficiary's bank in State B. When the transfer is carried out in that manner, there is a sending bank and a receiving bank in two different States and the credit transfer is subject to the Model Law.

8. There is one situation where the transfer between two banks in State A denominated in the currency of State B would not be international and a second where it is not clear whether it would be international. The transfer would not be international if there was a clearing in State A in the currency of State B and the transfer was executed through that clearing, since no payment order would be sent between State A and State B.

9. It is not clear whether the transfer is international where the originator's bank in State A sends its payment order directly to the beneficiary's bank in State A and pays the beneficiary's bank the amount of that payment order by sending a second payment order to its correspondent bank in State B with instructions to credit, or to cause to be credited, the account of the beneficiary's bank at the correspondent bank. It has been said that in such a case the instruction from the originator's bank to the third (reimbursing) bank to credit the account of the beneficiary's bank is a separate credit transfer from the credit transfer between the originator's bank and the beneficiary's bank. Under that interpretation, the transfer between the originator's bank and the beneficiary's bank in the currency of State B is not an international credit

transfer under paragraph (1). However, the credit transfer by which the originator's bank instructs its correspondent bank in State B to reimburse the beneficiary's bank by crediting its account would be an international credit transfer and subject to the Model Law. That interpretation was given at the twenty-first session, but it does not figure in the report of the session. However, that interpretation was specifically rejected at the twentieth session of the Working Group when the concern was whether a reimbursing bank was an "intermediary bank" (A/CN.9/329, paras. 70 and 71; see comment 44 to article 2).

10. Opposition to the results described in comments 7 to 9 were expressed at the twenty-first session, as well as at the eighteenth session when a similar proposal was before the Working Group, because of the possibility that the same instruction from the originator might be subject to the Model Law or not depending on the particular means of settlement chosen. It was said that even the originator's bank might not know the routing the credit transfer would take or the settlement procedures to be used where the originator's bank sent its payment order to another bank in the same State that handled international and foreign currency transfers (A/CN.9/318, paras. 25 to 26 and A/CN.9/341, para. 62). At the eighteenth session it was said that that result was not appropriate since the transfer would otherwise be identical from an economic point of view. At the twenty-first session the results described in comments 7 to 9 were accepted since it would always be possible for the originator to specify to its bank the routing of the credit transfer.

11. Since the application of the Model Law depends on the existence of two banks in different countries, normally it would not apply where the originator and the beneficiary had their accounts in the same bank. However, according to paragraph (2), for the purposes of the sphere of application of the Model Law, branches of a bank in different States are considered to be separate banks. Therefore, a transfer is within the application of the Model Law even though only one bank is involved when the originator's account and the beneficiary's account are in branches of that bank in different States.

12. Restricting application of the Model Law to international credit transfers means that a State that adopts the Model Law will potentially have two different bodies of law governing credit transfers, one applicable to domestic credit transfers and the Model Law applicable to international credit transfers. In some countries there are no domestic credit transfers or the domestic elements of international transfers are segregated from purely domestic transfers. In other countries domestic credit transfers and the domestic elements of international transfers are processed through the same banking channels. In those countries it would be desirable for the two sets of legal rules to be reconciled to the greatest extent possible or for the Model Law to be adopted for both domestic and international credit transfers.

Territorial scope of application

13. Since the Model Law is being prepared for international credit transfers, questions of conflict of laws

naturally arise. The relevant provisions are contained in article 15. Article 15(1) has the effect of limiting the territorial application of the Model Law.

Consumer transfers

14. The Working Group decided at its eighteenth session that the Model Law should apply to all international credit transfers, including transfers made for consumer purposes. Not only would that preserve the basic unity of the law, it would avoid the difficult task of determining what would be a credit transfer for consumer purposes. That was also thought to be of importance since special consumer protection legislation affecting credit transfers currently exists, and could be envisaged in the future, in only some of the countries that might consider adopting the Model Law.

15. At the same time, it was recognized that the special consumer protection legislation that exists in some countries, and that may be adopted in others, could be expected to affect some international credit transfers as well as domestic credit transfers. To accommodate that possibility, the footnote to article 1 was adopted to indicate that the Model Law would be subject to any national legislation dealing with the rights and obligations of consumers, whether the provisions of that legislation supplemented or contradicted the provisions of the Model Law (A/CN.9/318, paras. 30 to 33). The footnote was reconsidered at the twentieth session where no change was made (A/CN.9/329, para. 24).

16. At the twenty-first session the Working Group decided that the footnote should be reworded to state that the Model Law was not intended to deal with issues related to the protection of consumers (A/CN.9/341, para. 65). It may be noted that consumers who are originators or beneficiaries of credit transfers have the same rights, obligations and protections under the Model Law as do all other originators and beneficiaries. No text was adopted to implement the Working Group's decision. The Working Group may wish to consider the following text:

"This Law does not deal with issues related to the protection of consumers as a special class of [bank customers] [originators and beneficiaries]."

Comparison with Article 4A

17. Article 4A applies to both domestic and international credit transfers that fall within its scope of application based upon the conflict of laws rules in Article 4A-507. For a discussion, see comments 1 to 10 to article 15.

18. Article 4A-108 excludes from the coverage of Article 4A any transfer that is governed by the Electronic Fund Transfer Act of 1978. While that exclusion covers almost all transfers by or for the benefit of consumers, it does not exclude the relatively rare transfers made for consumer purposes that use the facilities of CHIPS, FEDWIRE or of the Society for Worldwide Interbank Financial Telecommunication (SWIFT).

Article 2. Definitions

For the purposes of this Law:

(a) "Credit transfer" means the series of operations, beginning with the originator's payment order, made for the purpose of placing funds at the disposal of a designated person. The term includes any payment order issued by the originator's bank or any intermediary bank intended to carry out the originator's payment order.

(b) "Payment order" means an unconditional instruction by a sender to a receiving bank to place at the disposal of a designated person a fixed or determinable amount of money if:

- (i) Deleted
- (ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and
- (iii) the instruction is to be transmitted either directly to the receiving bank, or to an intermediary, a funds transfer system, or a communication system for transmittal to the receiving bank.

(iv) Deleted

(c) "Originator" means the issuer of the first payment order in a credit transfer.

(d) "Beneficiary" means the person designated in the originator's payment order to receive funds as a result of the credit transfer.

(e) "Sender" means the person who issues a payment order, including the originator and any sending bank.

(f) "Bank" means an entity which, as an ordinary part of its business, engages in executing payment orders.

(g) A "receiving bank" is a bank that receives a payment order.

(h) "Intermediary bank" means any receiving bank other than the originator's bank and the beneficiary's bank.

(i) "Funds" or "money" includes credit in an account kept by a bank and includes credit denominated in a monetary unit of account that is established by an intergovernmental institution or by agreement of two or more States, provided that this Law shall apply without prejudice to the rules of the intergovernmental institution or the stipulations of the agreement.

(j) "Authentication" means a procedure established by agreement to determine whether all or part of a payment order [or a revocation of a payment order] was issued by the purported sender.

(k) "Execution date" means the date when the receiving bank is to execute the payment order in accordance with article 9.

(l) "Payment date" means the date specified in the payment order when the funds are to be placed at the disposal of the beneficiary.

Prior discussion

- A/CN.9/297, paras. 24 to 28
- A/CN.9/317, paras. 26 to 47
- A/CN.9/318, paras. 35 to 59, 75, 76, 94 and 106
- A/CN.9/328, paras. 79 and 88
- A/CN.9/329, paras. 26 and 82
- A/CN.9/341, paras. 66 to 84

Comments

1. The Working Group at its sixteenth session expressed the view that, in order to harmonize to the greatest extent possible the terms as used by bankers and as used in legal rules governing credit transfers, an effort should be made to use the terminology adopted by the Committee on Banking and Related Financial Services of the International Organization for Standardization in ISO 7982-1 (A/CN.9/297, paras. 25 to 28). However, in view of the fact that the ISO terminology had not been adopted with legal considerations in mind, some deviation from both the terminology and the definitions had to be envisaged. Various definitions have been considered at the seventeenth, eighteenth, nineteenth, twentieth and twenty-first sessions.

2. The comments below indicate the extent to which the terms used and their definitions differ from those in ISO 7982-1.

Chapeau

3. At the twentieth session the Working Group decided to introduce article 2 with the words "For the purposes of this Law", especially since some of the terms such as "bank" may be defined in other ways in the statutory law of a State that adopts the Model Law (A/CN.9/329, para. 26).

"Credit transfer"

4. The definition as adopted by the Working Group at its eighteenth session was based upon the definition of "funds transfer" in ISO 7982-1. However, certain amendments were made to the ISO definition in order to clarify its meaning. (See A/CN.9/318, paras. 36 to 38 and A/CN.9/WG.IV/WP.44, article 2, comments 4 to 6.)

5. At the twentieth session the Working Group adopted the current definition. When doing so it recognized that the definition of "credit transfer" and the associated definition of "payment order" were of particular importance since article 1 on the sphere of application provided that the law applied to credit transfers (A/CN.9/329, paras. 27 to 33). Therefore, the definition of the term serves in part to determine the sphere of application of the Model Law.

6. A credit transfer is defined in terms of the actions taken in regard to payment orders, and not in terms of the movement of funds as in an earlier definition. The types of transfers to be covered by the Model Law are also affected by the definition of "payment order".

7. The definition of "credit transfer" as adopted at the twentieth session included in square brackets a third sentence that provided when the credit transfer is completed (A/CN.9/329, para. 33). At the twenty-first session the sentence was deleted in view of the adoption of a provision on completion of a credit transfer in article 14(2 *bis*) (A/CN.9/341, para. 72).

8. *Comparison with Article 4A.* The definition of "credit transfer" is almost identical to the definition of "funds transfer" in Article 4A-104.

"Payment order"

9. In accordance with a suggestion made at the seventeenth session of the Working Group, the minimum data elements necessary to constitute a payment order were included in the definition of the term submitted to the eighteenth and nineteenth sessions (A/CN.9/317, para. 54). At the nineteenth session the drafting group separated the definition into two elements, a definition in article 2 and the requirements as to the minimum data elements in a payment order in article 3 (A/CN.9/328, para. 145 and annex).

10. At the twentieth session of the Working Group the minimum data elements in a payment order as set out in article 3 were deleted from the draft Model Law (A/CN.9/329, paras. 89 to 93). Nevertheless, the existence of an incomplete payment order has consequences in regard to the credit transfer. Those consequences are considered in articles 5 to 8.

11. The basic elements of the current definition of "payment order" were adopted at the twentieth session to accord with the new definition of "credit transfer" adopted at that session (A/CN.9/329, paras. 34 to 58).

12. It was decided not to make any reference to the form in which the payment order might exist, i.e. written, oral or magnetic, or to the form in which it might be transmitted from the sender to the receiving bank. On the one hand, any listing might exclude new technological advances. On the other hand, in some countries restrictions on the use of particular forms for the existence or transmission of a payment order might be of a regulatory nature. In the absence of any provision on this point in the Model Law, it would be settled under other applicable provisions of national law.

13. At the twentieth session the Working Group agreed that the Model Law should not govern conditional payment orders that were to be sent from one bank to another, and decided that such orders would not be considered to be "payment orders" (A/CN.9/329, paras. 40 to 42 and 50 to 53). However, a conditional payment order issued by the originator was a "payment order" according to subparagraph (i) if the condition was to be satisfied on or before the issue of a payment order by the originator's bank. Consequential provisions were included to assure that the condition would not affect subsequent receiving banks or the beneficiary. In addition, subparagraph (iv) provided that an instruction to open a letter of credit was not a payment order, a provision that was thought to be

necessary in view of the conditional nature of such an instruction.

14. Nevertheless, opposition was expressed at the twentieth session to even such a restricted recognition of conditional payment orders as falling within the sphere of application of the Model Law. It was noted that article 5(1) did not give the originator's bank any extra time within which to consider whether it wished to be bound by a conditional payment order before the bank was deemed to have accepted the order (A/CN.9/329, para. 52).

15. At the twenty-first session the Working Group decided that a conditional payment order should not be considered to be a payment order under the Model Law (A/CN.9/341, para. 73). That result was achieved by inserting the word "unconditional" in the *chapeau* of the definition and by deleting subparagraph (i). In addition, subparagraph (iv) was deleted as being unnecessary (A/CN.9/341, para. 79).

16. The Working Group recognized that, by saying that a conditional payment order was not a payment order under the Model Law, the sender of that order was not an originator and, consequently, had no rights or obligations under the Model Law. Therefore, if the credit transfer was not carried out properly for reasons unconnected with the original condition, any rights the customer might have would arise from rules of law outside the Model Law. Consequently, the Working Group decided that a provision should be included in the Model Law giving the sender of a conditional payment order the rights of an originator of a credit transfer where the execution of the conditional payment order eventually resulted in an unconditional credit transfer (A/CN.9/341, paras. 74 and 75). In a communication to the Secretariat subsequent to the twenty-first session the delegation of the United Kingdom suggested the following addition to the definition of "originator" in article 2(c) in implementation of that decision:

"or, where the first payment instruction is not a payment order because it is subject to a condition which subsequently is satisfied, the issuer of that instruction".

17. The delegation of the United Kingdom pointed out, however, that the conditional instruction would still not be a "payment order", which could give rise to difficulties in the interpretation of expressions such as "originator's payment order". As a consequence, while it stated its reluctance to include any reference to conditional instructions, it suggested that an approach preferable to the one decided by the Working Group would be to add the following at the end of the definition of "payment order":

"Where an instruction is not a payment order because it is issued subject to a condition, and the condition is subsequently satisfied, the instruction shall be treated as if it had been unconditional when it was issued; but this shall not affect the rights or obligations of any person in respect of the instruction during the period before the condition was satisfied."

18. At the twenty-first session deletion of subparagraph (ii) was suggested on the grounds that the question

of reimbursement of the receiving bank should be left for the originator and its bank to agree upon on a contractual basis. However, the subparagraph was retained on the grounds that it was necessary in order to exclude debit transfers from the scope of the Model Law (A/CN.9/341, para. 76).

19. Subparagraph (iii) is also intended to draw a distinction between debit transfers and credit transfers. A proposal at the twenty-first session to delete the subparagraph received no support. Various drafting proposals were made both before the twenty-first session (A/CN.9/WG.IV/WP.46, comment 16 to article 2) and during the session (A/CN.9/341, paras. 77 and 78) intended to make sure that the subparagraph could in fact apply only to a credit transfer.

20. It would seem that the distinction between a payment order that forms part of a credit transfer and an instruction that forms part of a debit transfer is that in the former case the instruction is transmitted by the sender to the receiving bank while in the latter case it is transmitted by the sender to the beneficiary, who in turn transmits it to the receiving bank. In both credit and debit transfers the transmission to the receiving bank may be made directly or the services of an intermediary may be used. However, it would seem that the meaning should be sufficiently clear if subparagraph (iii) were to provide

“the instruction is to be transmitted by the sender to the receiving bank”

or, in order specifically to exclude debit transfers,

“the instruction is to be transmitted by the sender to the receiving bank by any intermediary other than the beneficiary”.

21. *Comparison with Article 4A.* Article 4A-103 defines “payment order” in substantially similar terms.

“Originator”

22. The definition differs from the wording of the definition in ISO 7982-1, but not from its meaning. It was approved by the Working Group at its seventeenth, eighteenth and twentieth sessions (A/CN.9/317, para. 32; A/CN.9/318, para. 41; A/CN.9/329, para. 59). Under the definition a bank that issues a payment order for its own account is an originator.

23. In comment 16 it is suggested that the following words be added to the definition in implementation of the decision that the sender of a conditional payment order that results in an unconditional credit transfer should be considered to be the originator of the transfer:

“or, where the first payment instruction is not a payment order because it is subject to a condition which subsequently is satisfied, the issuer of that instruction”.

24. *Comparison with Article 4A.* Article 4A-104(c) defines “originator” in almost identical terms to the current text. “Originator’s bank” (which is not defined in the Model Law) is defined in Article 4A-104(d) to include

“the originator if the originator is a bank”. That is inconsistent with the Model Law, though the inconsistency probably does not have any substantive consequences in light of the current sphere of application in article 1 of the Model Law.

“Beneficiary”

25. The definition differs from the wording of ISO 7982-1 in that the beneficiary is the person named as beneficiary in the originator’s payment order and a person whose account is credited in error is not a beneficiary (A/CN.9/318, para. 42; A/CN.9/329, para. 69). For the situation where the identity of the beneficiary is expressed both by words and by account number and there is a discrepancy between them, see article 8(5). Similarly to the rule in regard to an originator, a bank may be the beneficiary of a transfer.

26. *Comparison with Article 4A.* Article 4A-103(a)(2) defines “beneficiary”, while “beneficiary’s bank” (not defined in the Model Law) is defined in 4A-103(a)(3). The definitions seem to be generally consistent with the usage in the Model Law.

“Sender”

27. The Working Group decided at its seventeenth and eighteenth sessions that the term should include the originator as well as any sending bank (A/CN.9/317, para. 46; A/CN.9/318, para. 44; see also A/CN.9/329, para. 61). ISO 7982-1 defines “sending bank” as the “bank that inputs a message to a service” but it has no term that includes the originator as a sender. Such a term is not necessary in the context of ISO 7982-1.

28. *Comparison with Article 4A.* Article 4A-103(a)(5) defines “sender” consistently with the Model Law.

“Bank”

29. The Working Group at its eighteenth session agreed to use the word “bank” since it was short, well-known and covered the core concept of what was intended (A/CN.9/318, para. 46; but see comments 37 and 38). The definition in the Model Law will necessarily differ from that used in national legislation since there are different definitions in various countries and in some countries there are two or more definitions for different purposes.

30. The definition in ISO 7982-1 is that a bank is “a depository financial institution”. The Working Group at its eighteenth session was of the view that the test as to whether a financial institution should have the rights and obligations of a bank under the Model Law should depend on whether “as an ordinary part of its business it engaged in credit transfers for others”, rather than whether it engaged in the totally unrelated activity of taking deposits (A/CN.9/318, para. 50). As a result, some individual financial institutions that would not normally be considered to be banks, such as dealers in securities that engage in credit transfers for their customers as an ordinary part of their business, would have been considered to be banks for

the purposes of the Model Law under the definition adopted at the eighteenth session.

31. The Working Group at its twentieth session made three changes in the definition (A/CN.9/329, paras. 62 to 68). First, it replaced the words "financial institution" by the word "entity". It was said that the Model Law was intended to govern a service and not particular systems. The change in the definition was specifically intended to bring under the Model Law those post offices that provide a service for the execution of payment orders, even though they may otherwise be governed by different rules because of their administrative status. That position was reaffirmed at the twenty-first session, despite some continuing opposition (A/CN.9/341, para. 66).

32. A second change made at the twentieth session was that the definition focuses on the execution of payment orders rather than, as it had previously, on whether the entity engages in credit transfers. At the twenty-first session the Working Group decided that the definition of a bank should not be extended to cover entities that only occasionally executed payment orders (A/CN.9/341, para. 69).

33. A third change made at the twentieth session was that the words "and moving funds to other persons" were added, but those words were placed in square brackets by the drafting group. At the twenty-first session it was said that the words should be retained so as to exclude message systems from the definition of a "bank". However, it was decided to delete the words in square brackets and to add a second sentence to state specifically that entities that merely transmitted payment orders were not banks (A/CN.9/341, para. 68).

34. It is clear that the Working Group's decision was intended to exclude the postal authorities from the definition of "bank" when they were exercising their function of operating a public message system such as telex, but not when they were exercising their function of operating a credit transfer system. It is also clear that the policy decision was to extend to all similar message systems, which presumably included clearing-houses. However, it is not clear that the decision can be adequately implemented by a new second sentence that says "Entities that merely transmit payment orders are not banks."

35. A message system such as telex "merely" transmits messages, but a message system such as SWIFT gives value-added services. Even more services are given by a clearing-house, such as CHAPS or CHIPS. In some clearing-houses, such as the Swiss Interbank Clearing (SIC), an account is opened each morning for each participating bank by transfer from the bank's reserve account with the Swiss National Bank. Payment orders sent by the bank through SIC are debited to the account while payment orders received by SIC for the account of the bank are credited to the account. The rules governing SIC do not permit a debit balance in an account at any time, thereby excluding any financial risk to other participating banks if one of the banks should be closed during the day because of its insolvency. It would seem that the suggested new sentence would not exclude any of those

entities, other than the telex service, from the definition of "bank". Moreover, there is the danger that the sentence would suggest that a message system that did more in respect of a payment order was a bank. That might be particularly so for SIC and any other clearing-house that established accounts for the debiting and crediting of payment orders sent and received by participating banks. (See comment 44 to article 4.) The Secretariat is unable to suggest any other wording that would accomplish the desired purpose without creating other possibilities of misunderstanding. Therefore, it suggests that the current text without a second sentence is the most likely to be properly interpreted.

36. *Comparison with Article 4A.* Article 4A-105(a)(2) defines a "bank" as "a person engaged in the business of banking" and goes on to list several types of institutions that are included.

Proposed new term for "bank"

37. At the twenty-first session the Working Group requested the Secretariat to reconsider the possibility of using a word other than "bank" and to report to the twenty-second session (A/CN.9/341, para. 70). The Working Group recognized that any word chosen would need to serve in such compound terms as "receiving bank".

38. It would seem that if an alternative term were chosen that had an existing well understood meaning, the problems that are seen in connection with the use of the word "bank" would arise in connection with the alternative term. That is particularly so since the term would be used in six official languages and may be translated into a number of other languages when the Model Law is used as the basis for national legislation. It is suggested that a new term associated with the subject matter of the Model Law might be created. The term the Secretariat would suggest would be "credit transfer institution". The term has the disadvantage of being long, especially when compared with the word "bank". However, it has the advantage of combining well with the modifiers used in the Model Law, i.e., sending, receiving, originator's, intermediary, and beneficiary's.

Proposed definition of "branch"

39. An earlier version of the definition of "bank" provided that "for the purposes of these Rules a branch of a bank is considered to be a separate institution." At the eighteenth session of the Working Group the sentence was deleted and it was decided that consideration would be given in each of the substantive articles whether branches should be treated as banks (A/CN.9/318, para. 54). Paragraphs indicating that branches of a bank are considered as separate banks have been added to articles 1(2), 6(7), 9(5) and 10(9) (A/CN.9/318, paras. 53 and 54; A/CN.9/328, paras. 82 and 110; A/CN.9/329, para. 141).

40. At the twenty-first session it was suggested that the Model Law should contain a definition of a "branch" of a bank (A/CN.9/341, para. 71). It was said that under

some national laws "branches" were defined in a restrictive way that would not cover certain offices or agencies of a bank that might be intended to be treated as separate banks under the Model Law. It was proposed that the significant feature of a "branch" under the Model Law should be that it sent and received payment orders. That proposal was objected to on the ground that the sending and receiving of payment orders were acts that could be carried out by simple message carriers. The delegation that had raised the question was invited, if it so wished, to prepare a draft definition and submit it to the twenty-second session. In the absence of any draft definition that might be submitted by the delegation, the Working Group might consider that the desired result would be achieved if articles 1(2), 6(7), 9(5) and 10(9) were to read "branches or separate offices of a bank are considered to be separate banks", as appropriately modified for the context.

41. *Comparison with Article 4A.* Article 4A-105(a)(2) provides that "A branch or separate office of a bank is a separate bank for purposes of this Article."

"Receiving bank"

42. Although the Working Group at its eighteenth session modified the wording of the definition from that found in ISO 7982-1, the meaning remained the same (A/CN.9/318, paras. 55 to 57). A bank that receives a payment order is a receiving bank even if the payment order was not addressed to it. Such a bank must react to the fact of having received the order. (The problem of misdirected payment orders is addressed in articles 6(3) and 8(2).) A bank to which a payment order is addressed but which does not receive it is not a receiving bank. It would not be appropriate to place upon it the obligation of a receiving bank in regard to a payment order that it did not know about.

43. *Comparison with Article 4A.* Article 4A-103(a)(4) defines a "receiving bank" as "the bank to which the sender's instruction is addressed", and not the bank that in fact receives the instruction. It is not clear whether that distinction is of significance in Article 4A. In most contexts the term "receiving bank" seems to include the beneficiary's bank, but in other contexts a distinction seems to be drawn between the two (e.g., Article 4A-301(a)).

"Intermediary bank"

44. The definition was proposed by the Working Group at its seventeenth session and modified at its twentieth session by the drafting group (A/CN.9/317, para. 41; A/CN.9/329, para. 72). It differs from the definition in ISO 7982-1 in three substantial respects: first, it includes all receiving banks other than the originator's bank and the beneficiary's bank, whereas ISO 7982-1 includes only those banks between the given receiving bank and the beneficiary's bank; secondly, ISO 7982-1 includes only those banks between the receiving bank and the beneficiary's bank "through which the transfer must pass if specified by the sending bank"; and thirdly, reimbursing banks are included in this definition, even though the

transfer may be considered not to pass through them and they are not in the chain of payment orders from the originator to the beneficiary's bank (A/CN.9/329, paras. 70 and 71). See also comment 9 to article 1.

45. *Comparison with Article 4A.* Article 4A-104(b) defines "intermediary bank" in almost identical terms to that in the Model Law.

"Funds" or "money"

46. The definition is modelled on the definition of "money" or "currency" contained in article 5(1) of the United Nations Convention on International Bills of Exchange and International Promissory Notes (A/CN.9/318, para. 59). However, it specifies that the term includes credit in an account, as is proper in the context of the Model Law. The definition was modified by the drafting group at the nineteenth session in accordance with the suggestion contained in A/CN.9/WG.IV/WP.41, article 2, comment 16. At the twentieth session it was noted that the definition included the ECU (A/CN.9/329, para. 73).

"Authentication"

47. The purpose of an authentication procedure is to permit the receiving bank to determine whether the payment order was issued by the purported sender. Even if the payment order was not authorized, the purported sender will be bound if the requirements of article 4(2) are met, including the requirement that "the authentication provided is a commercially reasonable method of security against unauthorized payment orders".

48. The definition makes it clear that an authentication of a payment order does not refer to formal authentication by notarial seal or the equivalent, as it might be understood in some legal systems.

49. The definition differs from the definition of "message authentication" in ISO 7982-1 in that authentication as here defined does not include the aspect of validating "part or all of the text" of a payment order, even though most authentication techniques that rely upon the use of computers do both. That position was confirmed by the Working Group at its twentieth session because the problems of authentication of a payment order as to its source and verification of the accuracy of its contents were two different legal concepts. In respect of the source of a message, the basic rule in article 4(1) is that the purported sender is not bound by a payment order unless the order had in fact been issued or authorized by the purported sender. The concept of authentication and its use in article 4(2) served to describe situations in which the purported sender might be bound by a payment order in spite of the fact that the order had not been issued or authorized by that person. In respect of errors, the Working Group noted that the general rule was that the sender was bound by what was received by the receiving bank (A/CN.9/329, paras. 77 to 79) (although that conclusion is not specifically stated in the current draft of article 4(1) or of any other provision of the Model Law). The Working Group went on to say that if it was intended that the Model Law

should relieve the sender of that responsibility because of the availability of a procedure agreed between the sender and the receiving bank that would detect errors in a payment order or corruption of the contents of a payment order, that intention should be set out separately in the Model Law. At the twenty-first session the Working Group decided that, in its discussion of article 4, it would consider issues having to do with verification that the contents of a payment order as received were the same as the contents of the payment order as sent (A/CN.9/341, para. 81). See comments 20 to 25 to article 4.

50. The Working Group was in agreement at its twentieth session that, if article 10 was retained, the definition of authentication should apply to the revocation of payment orders. However, since there was opposition to the basic scheme of article 10, the words "or a revocation of a payment order" were placed in square brackets (A/CN.9/329, paras. 76 and 184 to 186).

51. The definition as adopted by the Working Group at its eighteenth session and modified at its twentieth session includes the provision that the authentication procedure is established by agreement; a procedure applied unilaterally by the receiving bank does not qualify as an authentication (A/CN.9/318, paras. 75, 76 and 94; A/CN.9/329, paras. 74 and 76). That agreement may be embodied in the rules of a clearing-house or message system or it may be in the form of a bilateral agreement between the sender and the receiving bank. Under article 4(2) the authentication procedure must be "commercially reasonable" in order for a purported sender to be bound by an unauthorized payment order; a sender cannot agree to be bound by a commercially unreasonable procedure (see article 4, comments 7 to 9).

52. *Comparison with Article 4A.* Article 4A-201 defines "security procedure" in terms that are similar to the definition of "authentication", except that it applies as well to a procedure for the purpose of "detecting error in the transmission or the content of the payment order or communication". The provision goes on to give several examples of what the security procedure may require, and specifically states that comparison of a signature is not by itself a security procedure.

"Execution date"

53. There is no equivalent term in ISO 7982-1, except to the extent that the term "value date", i.e., "the date on which the funds are to be at the disposal of the receiving bank", is intended to be used in a payment order to indicate the date when the receiving bank is to execute the order (see A/CN.9/341, para. 82).

54. The execution date is the date when a given payment order is to be executed by the receiving bank and not the date the receiving bank did execute it, if those dates are not the same. See comments 27 and 28 to article 4. Since a credit transfer may require several payment orders, each of those payment orders may have an execution date, and the execution dates may be different.

55. The Working Group at its eighteenth and nineteenth sessions engaged in an extensive effort to define properly the term "execution date", especially in connection with its use in article 9 (A/CN.9/318, paras. 104 to 106; A/CN.9/328, paras. 76 to 91; see also A/CN.9/WG.II/WP.44, article 2, comments 27 to 31 where the earlier discussion is summarized). The current definition was adopted by the Working Group at its twentieth session (A/CN.9/329, paras. 81 and 182). As to the date when article 9 requires the receiving bank to execute the payment order, see article 9, comments 5 and 12.

56. The current draft of the Model Law does not define what constitutes execution of the payment order by the receiving bank. A proposal at the twenty-first session to add such a definition did not receive sufficient support (A/CN.9/341, para. 80). When the bank is not the beneficiary's bank, an order can be assumed to be executed when the receiving bank issues a payment order intended to carry out the order received (compare article 5(2)(d) with article 6(2)). When the receiving bank is the beneficiary's bank, execution is probably best understood as acceptance of the order in any of the ways specified in article 7(1). If the sender wishes to specify when the funds are to be placed at the disposal of the beneficiary, a "payment date" should be specified. The term "execute" in one of its various forms is used throughout the draft Model Law in connection with payment orders. In addition, in article 12(2) reference is made to execution of the credit transfer, and a definition is there given of that concept.

57. *Comparison with Article 4A.* Article 4A-301(b) defines "execution date" substantively the same as in the current text. Article 4A-301(a) defines "execution" in respect of a bank that is not the beneficiary's bank. In contrast to the usage in the Model Law, Article 4A-301(a) goes on to say that "A payment order received by the beneficiary's bank can be accepted but cannot be executed." That difference in the formal statement seems to lead to no differences in substance between Article 4A and the Model Law.

"Payment date"

58. At the twenty-first session the question was raised whether the Model Law should contain any rules covering the use of a payment date and, consequently, whether there was any need for a definition (A/CN.9/341, paras. 82 and 83). It was noted that the payment messages used by SWIFT did not contain a field for such a date and, it was stated, ISO would delete any reference to a pay (or payment) date in its next revision of its standards. It was said that the date commonly used on payment orders between banks was the value date, i.e., the date on which the funds were to be available to the receiving bank. The suggestion that the term "execution date" could be made to serve the intended function of payment date was not adopted on the grounds that, even though payment orders used in inter-bank practice might not provide for the designation of a payment date, the original payment order sent by the originator to its bank might stipulate that the funds were to be paid to the beneficiary on a particular date.

59. At the twenty-first session the Working Group changed the term "pay date", that it had previously been using to indicate when the funds were to be placed at the disposal of the beneficiary, to "payment date" (A/CN.9/341, para. 83). With that change the terminology used in the Model Law is now in conformity with Article 4A but out of harmony with ISO 7982-1, since the term "pay date" is used by ISO 7982-1 to indicate the date when the funds are to be available to the beneficiary. ISO 7982-1 uses the term "payment date" to indicate the date when a payment was executed. The term "payment date" was included in the text prior to the seventeenth session of the Working Group with the same meaning as in ISO 7982-1 but, since it was not used further, it was deleted in the revision by the Secretariat submitted to the eighteenth session.

60. The definition of "payment date" differs from pay date in ISO 7982-1 in that in the latter the pay date is the "date on which the funds are to be available to the beneficiary for withdrawal in cash". In the Model Law definition the payment date is the date "when the funds are to be placed at the disposal of the beneficiary". (See A/CN.9/317, para. 43 and A/CN.9/341, para. 83) The definition leaves open the question when and under what circumstances funds are placed at the disposal of the beneficiary, but they may be at the disposal of the beneficiary even though they are not available for withdrawal in cash. The most obvious example is when the transfer is in a unit of account that may be at the disposal of the beneficiary for further transfer in that form but not available in cash either as a unit of account or, perhaps, even in the local currency.

61. At the twenty-first session the definition was modified to make it clear that the payment date binding on the receiving bank is the date specified in the payment order received by it. See A/CN.9/WG.IV/WP.46, comment 37 to article 2 and A/CN.9/341, para. 83. If a payment date specified in a payment order received by an intermediary bank or the beneficiary's bank is not in conformity with the payment date specified by the originator, the bank where the change in dates occurred would be responsible for the error. For the significance of a payment date in a payment order prior to the one received by the beneficiary's bank, see article 9, comment 17.

62. At the twenty-first session the Working Group was in agreement that the question should be reconsidered together with articles 9 and 12 and, therefore, it adopted the current text as an interim draft (A/CN.9/341, para. 84). See comment 18 to article 9.

63. *Comparison with Article 4A.* Article 4A-401 has a broader definition of "payment date" in that it is "the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank". Presumably the day is the day specified in the payment order received and not the day specified in the originator's payment order. The official comments indicate that the payment date may be expressed in various ways, presumably including the use of a type of credit transfer system that has a fixed time schedule of a certain number of days to process payment orders.

Article 3. *Contents of payment order*

(Deleted)

Prior discussion

A/CN.9/297, paras. 37 and 38

A/CN.9/317, paras. 49 to 68

A/CN.9/329, paras. 87 to 93

A/CN.9/341, para. 85

Comments

1. Article 3 of the draft Model Rules prepared by the Secretariat and submitted to the seventeenth session of the Working Group was entitled "form and content of payment order". In the light of the discussion at that session (A/CN.9/317, paras. 49 to 68), the substance of paragraphs (1) and (2) of article 3 were included in the definition of "payment order" in the redraft prepared for the eighteenth session of the Working Group. In particular, in accordance with a suggestion made in the seventeenth session of the Working Group, the minimum data elements necessary to constitute a payment order were included in the definition of the term (A/CN.9/317, para. 54). Inclusion of the minimum required data elements in the Model Law was expected to have an educational function.

2. At the nineteenth session the drafting group decided to delete the minimum required data elements from the definition of a payment order, since a message might be considered not to be a payment order if any one of the listed data elements was omitted (A/CN.9/328, para. 145; see A/CN.9/WG.IV/WP.41, article 2, comment 18), and to set out the required minimum data elements in article 3.

3. At the twentieth session the Working Group considered whether additional data elements should be made mandatory, and particularly information on cover and the identification of the originator and the originator's bank (A/CN.9/329, paras. 87 and 88). At the end of the discussion the Working Group decided to delete article 3 entirely (A/CN.9/329, para. 93). Problems of incomplete instruments are now considered in articles 6(4) and 8(3).

4. The Working Group also decided to address in some other provision the need for payment orders to disclose to receiving banks that the payment order formed part of an international credit transfer (A/CN.9/329, para. 93 and A/CN.9/341, para. 85).

CHAPTER II. DUTIES OF THE PARTIES

Article 4. *Obligations of sender*

(1) A purported sender is bound by a payment order [or a revocation of a payment order] if it was issued by him or by another person who had the authority to bind the purported sender.

(2) When a payment order is subject to authentication, a purported sender who is not bound under paragraph (1) is nevertheless bound if:

(a) the authentication provided is a commercially reasonable method of security against unauthorized payment orders, and

(b) Deleted

(c) the receiving bank complied with the authentication.

(3) A purported sender is, however, not bound under paragraph (2) if he proves that the payment order as received by the receiving bank resulted from the actions of a person other than a present or former employee of the purported sender, unless the receiving bank is able to prove that the payment order resulted from the actions of a person who had gained access to the authentication procedure through the fault of the purported sender.

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

Prior discussion

A/CN.9/297, paras. 39 to 45 and 69
A/CN.9/317, paras. 57, 69 to 79 and 84
A/CN.9/318, paras. 70 to 109
A/CN.9/329, paras. 94 to 111
A/CN.9/341, paras. 86 to 103

Comments

1. Paragraphs (1) to (3) set forth the situations in which a purported sender of a payment order is bound by the order. Paragraph (4) sets forth the only obligation of the sender in regard to a payment order on which it is bound, i.e. to pay the receiving bank for it.

Paragraph (1)

2. Paragraph (1) states the basic rule that a purported sender is bound by a properly authorized payment order. The question whether the actual sender was authorized to bind the purported sender will be determined in accordance with the applicable law and will not be determined by the Model Law. Moreover, at the twenty-first session it was decided that the question as to the law of which jurisdiction would be applicable would not be determined by article 15 (A/CN.9/341, paras. 46 and 47; see also comment 10 to article 15).

3. Pursuant to the words "or revocation of a payment order" the purported sender is also bound by a properly authorized revocation of a payment order. Those words have been placed within square brackets subject to a determination whether article 10 will be retained (A/CN.9/329, para. 96).

4. *Comparison with Article 4A.* Article 4A-202 provides an essentially identical rule to that in paragraph (1).

Paragraph (2)

5. Paragraph (2) has been drafted as an exception to paragraph (1), but from the viewpoint of banking

operations it provides the basic rule. In almost all cases a payment order must be authenticated. Proper authentication indicates proper authorization and the receiving bank will act on the payment order. Even if the payment order was not properly authorized under paragraph (1), the purported sender is bound by the order if the requirements of paragraph (2) are met (see A/CN.9/341, para. 86).

6. The Working Group may wish to consider deleting the words "When a payment order is subject to authentication" in the *chapeau* of paragraph (2). Those words were part of a technical amendment made at the twenty-first session to overcome the possible interpretation of paragraph (2), contained in the draft then before the Working Group, that even if the payment order had been authorized under paragraph (1), the sender was bound only if the requirements of paragraph (2) were also met (A/CN.9/341, para. 86; see A/CN.9/WG.IV/WP.46, comment 9 to article 4). The opening words do not seem to be necessary to achieve the result desired at the twenty-first session. However, they leave open the question as to when a payment order is subject to authentication, a question that does not need to be raised.

7. The first requirement, set out in subparagraph (a), is that the authentication provided is commercially reasonable. The discussion in the eighteenth session of the Working Group proceeded on the basis that it was the receiving bank that determined the type of authentication it was prepared to receive from the sender (A/CN.9/318, para. 75). Therefore, it was the receiving bank's responsibility to assure that the authentication procedure was at least commercially reasonable. If the receiving bank was willing to accept a payment order even though there was no commercially reasonable authentication, it should accept the risk that the payment order had not been authorized in accordance with paragraph (1) (A/CN.9/341, para. 94).

8. At the eighteenth session the Working Group was in agreement that the sender and the receiving bank could not provide for a lower standard by agreement (A/CN.9/318, para. 75). At the twenty-first session the Working Group noted that at that session it had adopted a new article 16 that stated a general principle of freedom of contract unless otherwise provided in the Model Law, and that it had decided to review each of the substantive articles to determine whether the previous statements as to the effect of an agreement should be retained (A/CN.9/341, para. 93). Consequently it decided to include in paragraph (2) a provision to the effect that parties would not be allowed to agree on the use of an authentication procedure that was not commercially reasonable (A/CN.9/341, para. 96). That decision might be implemented by the addition of a new sentence that would read as follows:

"The provisions of this paragraph may not be varied by agreement."

9. No attempt has been made to set a standard as to what constitutes a commercially reasonable authentication procedure. The standard would be objective, since it would be one from which the parties were not free to vary by agreement. However, since the commercial reasonableness of an authentication procedure would depend on

factors related to the individual payment order, including such factors as whether the payment order was paper-based, oral, telex or data transfer, the amount of the payment order and the identity of the purported sender, the statement of the parties in their agreement that they chose to use a procedure that was less protective than others available, especially if they explained the reasons why they had made that decision, could be expected to influence a court as to whether the standard chosen was commercially reasonable. It could be expected to be of particular importance that the receiving bank offered the sender at a reasonable price another authentication procedure that clearly was commercially reasonable, but the sender chose to use the less secure procedure for reasons of its own. The standard as to what was commercially reasonable could be expected to change over time with the evolution of technology. At the twentieth session of the Working Group it was suggested that, in view of the imprecision of the term "commercially reasonable" and the unfamiliarity of many legal systems with the concept, any commentary that might be written to accompany the Model Law when it is adopted by the Commission might give a suggestion as to factors to be taken into account (A/CN.9/329, para. 98).

10. A previous requirement, that had been set out in subparagraph (b), was that the amount of the payment order was covered by a withdrawable credit balance or authorized overdraft in an appropriate account of the sender with the receiving bank. That rule was said to afford a protection for originators in some countries. By limiting the amount that could be debited to an account, a customer could limit the amount of potential loss. Such a limitation also furnished to a limited degree an indication that an excessively large payment order might have been in error or fraudulent (A/CN.9/318, paras. 82 and 85 to 87; A/CN.9/329, paras. 100 and 101).

11. At the twentieth session a proposal to delete subparagraph (b) was rejected (A/CN.9/329, paras. 100 and 101). At the twenty-first session it was again proposed to delete the subparagraph (A/CN.9/341, paras. 87 to 91). The principal argument against the provision was that it was impractical from an operational point of view since banks could not monitor the accounts of senders on a real-time basis unless all the debits and credits that were chargeable to the account were entered on a real-time basis. It was said that in even the most highly automated banks some types of payment orders were processed in batch with the resulting debits and credits entered to the accounts periodically, and often at the end of the working day. In reply it was said that the rule in subparagraph (b) was a risk allocation rule and not an operational rule. The first decision made by the Working Group at the twenty-first session was to limit the application of subparagraph (b) to non-bank senders. Subsequently, in connection with its discussion of paragraph (3), it decided to delete subparagraph (b) (see comments 16 and 17).

12. What was the third, but is now the second, requirement is that the receiving bank complied with the authentication. If the bank complied with the authentication but the sender had not, the bank would know that the payment order had not been authenticated by the sender and should

reject it. However, even if the bank did not comply with the authentication but the payment order was in fact authorized, the purported sender would be bound under paragraph (1). The one occasion when subparagraph (c) would be truly dispositive would be in the case envisaged by paragraph (3), i.e., where an unauthorized payment order was properly authenticated by the actual sender but the receiving bank did not comply with the authentication procedure. In that case the sender would not be bound under paragraph (2) and there would be no occasion to turn to paragraph (3).

13. *Comparison with Article 4A.* Article 4A-202(b) provides essentially an identical rule with additional detail. Subparagraph (c) of Article 4A-202 gives an indication as to what would be "commercially reasonable".

Paragraph (3)

14. The paragraph was prepared in two versions at the eighteenth session of the Working Group (A/CN.9/318, paras. 88 to 90). In general, those who were in favour of placing on the receiving bank the major risk that an authentication had been falsified by a known or unknown third person favoured variant A. Placing the major risk on the receiving bank was said to be appropriate because it was the receiving bank that usually designed the authentication procedure (see comment 7). In general, those who were in favour of placing the major risk on the sender favoured variant B. Placing the major risk on the sender was said to be appropriate because it was the sender who chose the means of transmission of the particular payment order. Moreover, variant B would act as an incentive to senders to protect the authentication or encryption key in their possession.

15. The paragraph was discussed again at the twentieth session where several new proposals were made (A/CN.9/329, paras. 103 to 108). However, because of the failure to reach agreement, the Working Group left the text unchanged.

16. The current text was adopted at the twenty-first session (A/CN.9/341, paras. 97 to 101). Paragraph (3) deals with the relatively rare case when there has been an unauthorized payment order that was authenticated in accordance with paragraph (2) but was not authorized in accordance with paragraph (1). In such a case paragraph (3) provides that the purported sender must show that the payment order resulted from the actions of a person other than a present or former employee of the purported sender in order not to bear the loss. In order to meet that burden it would not be necessary to show who had sent the payment order; the fact that it could not have resulted from the actions of a present or former employee might be proved by other means. Once that burden has been met by the purported sender, the receiving bank must show that the authentication was procured by the fault of the purported sender in order to place the loss back on the purported sender.

17. With adoption of the new version of paragraph (3), the Working Group decided to delete paragraph (2)(b) (see comment 11).

18. After an extensive discussion at the twenty-first session the Working Group decided that it would leave the parties free to vary the provisions of paragraph (3) by agreement, as provided in article 16. A suggestion was made that it should not be possible to vary the provisions to the detriment of non-bank senders. Another suggestion was that there should be no limitation on the extent to which paragraph (3) could be modified by agreement, but that the agreement could not be in the general conditions of the receiving bank; the agreement would have to be in an individual contract between the purported sender and the receiving bank. The delegations that expressed strong reservations to the decision leaving the parties free to vary the provisions of paragraph (3) by agreement were concerned that the likelihood that the Model Law would be found acceptable by national legislatures would be seriously reduced.

19. *Comparison with Article 4A* Article 4A-203 is essentially the same as paragraph (3), but slightly more to the advantage of the receiving bank.

Errors in payment order or corruption of its contents

20. In the working paper submitted to the twentieth session of the Working Group suggestions were made as to how the authentication defined in article 2 and used in article 4 in respect of identification of the sender might also be used in respect of errors in a payment order or corruption of the contents of a payment order during its transmission (A/CN.9/WG.IV/WP.44, article 2, comment 23 and article 4, comment 10). The Working Group did not accept the suggestion that an authentication as defined should be used for both purposes. It said that, if it was intended that the Model Law should relieve the sender of the responsibility for the content of a payment order as it was received because of the availability of a procedure agreed between the sender and the receiving bank that would detect the error or corruption, that intention should be set out separately in the Model Law (A/CN.9/329, para. 79). At the twenty-first session the Working Group requested the Secretariat to propose a text that would implement this idea for consideration at its twenty-second session.

21. If it would be the desire of the Working Group to include such a rule, it would seem appropriate that it be in article 4 following current paragraph (3). The Working Group may wish to consider the following proposal:

"A sender who is bound by a payment order is bound by the terms of the order as received by the receiving bank. However, if the sender and the receiving bank have agreed upon a procedure for the detection of errors in a payment order, the sender is not bound by the payment order to the extent that use of the procedure by the receiving bank revealed or would have revealed the error."

22. The first sentence makes it clear that the sender bears the risk that the contents of the payment order as received by the receiving bank are not those intended to be sent, or those actually sent, by the sender. The discrepancy may have occurred as a result of an error by the

sender or because the contents of the payment order changed after being sent. The second sentence sets out the occasions when the sender would not be bound to the terms of the payment order as received. A prerequisite is that the sender and the receiving bank had agreed on the use of a procedure that would reveal some or all of the errors in the payment order. In contrast to the authentication procedure, there would be no requirement that the procedure was commercially reasonable, or that it was designed to reveal all errors. There is also no requirement that the procedure must require the sender to act; the only question is whether use of the procedure by the receiving bank in respect of the particular payment order received revealed the error or, if the receiving bank did not use the procedure, whether its use would have revealed the error. It is understood that the word "error" includes all discrepancies between the payment order as it was intended and the payment order as it was received, whatever be the source of the discrepancy. To some degree the proposed paragraph implements the same policy as do articles 6(3), (4) and (5) and 8(2), (3), (4) and (5) when the error in the payment order is in relation to the subject matter covered by those provisions. However, the proposed paragraph might most often be applicable to an error in the amount of money to be transferred when the amount was expressed only in figures.

23. Another wording has been suggested by the delegation of the United Kingdom as follows:

"Where the sender has agreed with a receiving bank that a payment order will be subject to a procedure to detect errors, and the sender complies with the procedure, the sender shall not be bound by the payment order if the bank, had it also complied with the procedure, would have detected that

(a) the payment order instructed payment to a beneficiary not intended by the sender, or

(b) was an erroneous duplicate of a payment order already sent by the sender.

If the error the bank would have detected was that the sender instructed payment of an amount greater than that intended by the sender, the sender shall be bound only to the extent of the amount that was intended."

24. The delegation of the United Kingdom pointed out that the proposed new paragraph does not deal with erroneously misdirected payment orders, which are dealt with in articles 6(3) and 8(2), and suggested an amendment to its prior proposal in this regard. See comments 8 to 11 to article 6, comment 6 to article 8 and comments 10 and 11 to article 9.

25. *Comparison with Article 4A.* Article 4A-205 gives results in respect of a "payment order . . . transmitted pursuant to a security procedure for the detection of error" that are similar to the results in article 4(2) in respect of an unauthorized but authenticated payment order. If the transfer was made to an incorrect beneficiary or was a duplicate transfer, "the receiving bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution", while if the transfer was for too great an

amount, the receiving bank could recover from the beneficiary "the excess amount received". To some degree the restitution provision in Article 4A-205 already exists in article 11(b), though article 11(b) permits each sender to recover from its receiving bank and not from the beneficiary. This difference in approach is explained in part by the fact that in principle the Model Law does not regulate the rights and obligations of the beneficiary.

Paragraph (4)

26. The distinction between creation of the obligation of the sender to pay the receiving bank when the receiving bank accepts the payment order and the maturing of the obligation to pay on the execution date is relevant when the execution date is in the future. The provision raises two separate problems: the obligation of the sender when the receiving bank fails to execute on the execution date and the obligation of the sender when the receiving bank accepts the payment order prior to the execution date.

27. At the eighteenth and twentieth sessions the use of the execution date as the date when the sender should be obligated to make the funds available to the receiving bank was questioned on the grounds that the execution date was defined in article 2(k) as the date the receiving bank was obligated to act and not the date the receiving bank had performed its obligation (A/CN.9/318, para. 104; A/CN.9/329, para. 109). At the twentieth session it was stated in reply that, while the sender should be obligated to pay on the execution date, the sender should receive interest under article 12 for the period of any delay by the receiving bank in executing the order. The latter suggestion appears to have been thought to have been the natural consequence of the text of the Model Law as currently drafted.

28. It can be doubted whether receiving banks will often accept payment orders for future execution prior to the execution date, unless the sender has already paid for the order. However, if the receiving bank executes the payment order prior to the execution date, it accepts the order at the time of its execution. While the sender can no longer revoke the order (article 10(1) and (2)), and becomes obligated to pay for it, the receiving bank may not debit the sender's account or otherwise require payment for the order until the execution date.

29. At the twentieth session it was stated that the sender's obligation to pay should extend only to the amount of the payment order and not to any costs or charges. That issue, however, was not resolved. Reference was made to the treatment of the issue in article 14(3) (A/CN.9/329, para. 110). Compare the discussion in regard to article 14(3) in comments 15 and 16 to article 14.

30. *Comparison with Article 4A.* Article 4A-402(b) and (c) are essentially the same as the Model Law. Exceptions are stated to the duty of the sender to pay in case of erroneous payment orders of various types.

Concept of payment and netting

31. The current text of the Model Law does not contain any provision that indicates how and when a sender would

pay for the payment order as it is required to do by paragraph (4). This lack of an indication as to how and when the sender pays for the payment order may cause problems in the implementation of articles 5(2)(a) and 7(1)(a) under which the receiving bank accepts a payment order by failing to give notice of rejection if, and only if, the receiving bank has received payment from the sender. The only relevant discussion has been in respect of netting.

32. At the nineteenth session the Working Group engaged in a preliminary discussion of the desirability of introducing a provision on netting into the Model Law. The Working Group noted that important studies on this issue were taking place elsewhere, and particularly in a committee of the central banks of the Group of Ten, presided by the General Manager of the Bank for International Settlements (BIS). Therefore, the Secretariat was requested to follow those developments and to report to the Working Group on the conclusions that had been reached, including the submission of a draft text for possible inclusion in the Model Law if that seemed appropriate (A/CN.9/328, paras. 61 to 65; see A/CN.9/WG.IV/WP.42, paras. 47 to 57). At the twenty-first session the Working Group noted that it might have to proceed with the preparation of provisions on netting without the benefit of the BIS study if the study was not available soon (A/CN.9/341, para. 53). Although it was expected that participants in the work of BIS on netting who were also participants in the Working Group would submit a text to the Secretariat for incorporation in this report, that has not been possible. Nevertheless, a few comments may be made on the concept of payment and on netting as it would affect the current text of the Model Law.

33. The normal means by which a sending bank pays the receiving bank for a high-value high-speed credit transfer is that the amounts being transferred are debited and credited to accounts held by the banks with one another or to accounts held with a third bank. That can give rise to any one of four situations:

(a) The sender has an account with the receiving bank. The receiving bank is paid by debiting that account. Since the receiving bank will debit the account only if the account has a credit balance, or if the receiving bank is willing to extend credit to the sender, it would seem reasonable for the receiving bank to be considered to be paid by the sender when the receiving bank debits the account.

(b) The receiving bank has an account with the sender. In such a case the sender would pay the receiving bank by crediting the receiving bank's account with the sender. Normally, the receiving bank should be considered to be paid when the account was credited, which could be prior to the sending of the payment order. However, the amount of the payment order by itself, or in conjunction with other payment orders sent by the sending bank, may be so large that it would create a credit balance larger than that which the receiving bank is willing to have with the sender. Therefore, it may be desirable to have a rule that payment is made in such a situation only when the receiving bank withdraws the credit (perhaps measured on a first-in first-out basis) or when a specified time has passed

after the account was credited or after the receiving bank knew of the credit.

(c) The receiving bank receives credit in its account with a third bank. The situation would be essentially the same as when the receiving bank received credit with the sender and the same rules might apply.

(d) The third bank in which the receiving bank receives credit is the central bank or its equivalent. In such a case payment may be considered to have been made when the credit was entered to the receiving bank's account.

34. Netting is used when it is not possible or desirable for one reason or another to make payment by debiting and crediting the individual transactions to an account as described above. Netting is an arrangement by which a set of two or more transactions creating financial rights and obligations between two or more parties during a defined period of time or coming due at a defined point of time are settled by calculation and payment of the net amount due by the participant or participants who on balance have remaining obligations. Netting may be used as a technique to reduce the number of transaction messages between the participants without changing the legal nature of the individual obligations. This is often referred to as "position netting". Until final settlement is made between the participants by the transfer of a single net amount by the participant with the debit balance between them, each one owes to the other the gross amounts due on each individual transaction.

35. Netting may also be structured in such a way as to merge the individual legal obligations into a single legal obligation for the net amount. Such a transformation of the legal obligations usually depends upon the use of the concept of novation, though the concept of set-off may also be used in some legal systems. It is not clear in some legal systems whether, in case of the insolvency of one of the participants in the netting arrangement prior to settlement of the net amounts, the legal representative of the insolvent person (or of the creditors of the insolvent person) would be bound to recognize the netting arrangement or whether a claim could be made for the gross amounts due to the insolvent while the gross amounts due by the insolvent to the other participant or participants were recoverable only in the liquidation proceedings.

36. So-called "netting by close-out", where the future obligations between two banks are to be reduced to a single net obligation in case of the occurrence of a defined event of default, such as the appointment of a receiver or liquidator of one of the banks, is relevant to forward exchange contracts but not to the payment system as such and need not be considered here.

37. In some types of financial transactions, such as the purchase and sale of currencies for future delivery, bilateral netting may take place. For example, when both of the two parties during the period in question buys and sells to the other party pounds against dollars, on the delivery date one of them will be obligated to deliver more pounds than that person has a right to receive and the other will be obligated to deliver more dollars than that person has

a right to receive. The two parties may then agree to deliver only the net amounts of pounds in the one direction and the net amount of dollars in the other rather than for each to deliver to the other the gross amounts of both pounds and of dollars that they have sold.

38. Although high-value high-speed credit transfers are not normally settled by bilateral netting, bilateral netting is more often used when two banks interchange payment orders in bulk by the manual transmission of magnetic tapes or the like. While the legal consequences of debiting and crediting incoming and outgoing payment orders to an account are in many respects similar to those intended to be achieved by netting by novation, the mechanics and the legal concepts involved are different. Therefore, it may be desirable to have a provision on bilateral netting in the Model Law.

39. *Comparison with Article 4A.* The provision on bilateral netting in the final version of Article 4A-403(c) is contained in the first two sentences of draft paragraph (3) as set out in A/CN.9/WG.IV/WP.42, para. 54.

40. Multilateral netting is a common feature in clearing-houses with delayed settlement, such as CHAPS and CHIPS. In such a clearing-house the value of payment orders sent and received during the day by the participants are recorded by the clearing-house. At the end of the day the net amounts due by each participant are calculated. The net calculation may be made first in respect of each bilateral relationship in the clearing-house with the individual nets then being netted into a net-net amount. Alternatively, the net-net amounts may be calculated directly. The settlement would be effected by those banks that on the net-net basis had a debit balance transferring sufficient funds to a settlement account to cover their debit balance while those banks that had a net-net credit balance would receive that amount from the settlement account. The settlement account might be with the clearing-house itself, but it is typically with the central bank.

41. The legal issues arising out of multilateral netting are of two types. First, payment of the sender to the receiving bank could be considered to have occurred when the payment order went through the clearing-house, since the sending bank would at that time be debited in respect of the settlement to be made at the end of the day and the receiving bank would be credited. Payment to the sender could also be considered to have taken place only when the settlement at the end of the day is completed. The decision as to when payment is considered to have been made would be heavily dependent on the second issue, namely what happens if one of the banks with a net-net debit balance is unable to transfer to the settlement account sufficient funds to cover the outstanding debit balance. If the transfers that have been made through the clearing-house must be reversed in whole or in part in order to permit the settlement to be completed in respect of the remaining transfers, it is logical to draw the conclusion that no sender has paid the receiving bank of any particular payment order until the settlement is complete. If no transfer is to be reversed upon the failure of a bank to meet its obligations in the settlement, either because the central bank or other adequate entity guarantees the

settlement or because a loss-sharing arrangement between all participating banks is in place, it is logical to conclude that the receiving bank receives payment from the sender when it receives the payment order through the clearing-house.

42. A provision in the Model Law in respect of multilateral netting might settle one or more of three separate issues:

(a) Whether, as a matter of law, the debits and credits arising out of the sending of payment orders through the clearing-house are to be netted, and if they are, whether the netting is to take place on a bilateral basis between each pair of banks or whether it is to take place on a multilateral basis.

(b) Whether some or all of the payment orders that have been sent through the clearing-house are to be reversed in case one of the participating banks is unable to meet its obligations in the settlement.

(c) The time when payment is considered to have been made by the sender to the receiving bank.

43. *Comparison with Article 4A.* Article 4A-403(b), containing the provisions on multilateral netting, is set out in A/CN.9/WG.IV/WP.42, para. 54. Only minor editorial changes were made to that text in the finally adopted form. In addition, Article 4A-405(d) provides that a funds-transfer system rule may provide that payments made to beneficiaries of funds transfers made through the system are provisional until receipt of payment by the beneficiary's bank of the payment order it accepted. For the rule to apply, it would not be necessary that the beneficiary's bank was the receiving bank of the order made through the funds-transfer system. Such a system rule would be most likely to be found in conjunction with a multilateral netting arrangement.

44. It should be noted that a payments clearing arrangement can be structured in such a manner that netting in the form discussed here is not necessary. An example is the Swiss Interbank Clearing (SIC), also discussed in comment 35 to article 2 in the context of the definition of a "bank". In SIC an account is opened each morning for each participating bank by transfer from the bank's reserve account with the Swiss National Bank. Payment orders sent by the bank through SIC are debited to the account while payment orders received by SIC for the account of the bank are credited to the account. The rules governing SIC do not permit a debit balance in an account at any time, thereby excluding any financial risk to other participating banks if one of the banks should be closed during the day because of its insolvency. In effect, from both an operational and, it would seem, a legal point of view SIC is in this limited context the equivalent of a correspondent bank of the sending and receiving banks. Therefore, the time of payment by the sending bank to the receiving bank would be governed as suggested in comment 33.

45. *Comparison with Article 4A.* Article 4A-403 provides when a sender pays a receiving bank under the circumstances described above. It contains a detailed provision on netting that is designed to accommodate the

new CHIPS rule that reduces the risk that the failure of one bank to settle will cause other banks to be unable to meet their settlement obligations.

Article 5. Acceptance or rejection of a payment order by receiving bank that is not the beneficiary's bank

(1) The provisions of this article apply to a receiving bank that is not the beneficiary's bank.

(2) A receiving bank accepts the sender's payment order at the earliest of the following times:

(a) when the time within which a required notice of rejection should have been given has elapsed without notice having been given, provided that acceptance shall not occur until the receiving bank has received payment from the sender in accordance with article 4(4),

(b) when the bank receives the payment order, provided that the sender and the bank have agreed that the bank will execute payment orders from the sender upon receipt,

(c) when it gives notice to the sender of acceptance, or

(d) when it issues a payment order intended to carry out the payment order received.

(3) A receiving bank that does not accept a sender's payment order, otherwise than by virtue of subparagraph (2)(a), is required to give notice to that sender of the rejection, unless there is insufficient information to identify the sender. A notice of rejection of a payment order must be given not later than on the execution date.

Prior discussion

A/CN.9/297, paras. 46 to 51
A/CN.9/317, paras. 80 to 84
A/CN.9/318, paras. 110 to 120 and 126 to 134
A/CN.9/WG.IV/WP.42, paras. 7 to 16
A/CN.9/328, paras. 12 to 16
A/CN.9/329, paras. 112 to 127
A/CN.9/341, para. 53

Comments

1. The drafting group at the nineteenth session substantially restructured the portion of the draft Model Law dealing with acceptance of a payment order by a receiving bank and the statement of the obligations of a receiving bank. Under the new structure articles 5 and 6 deal with a receiving bank that is not the beneficiary's bank while articles 7 and 8 deal with the beneficiary's bank. Since a "receiving bank" is defined in article 2(g) in such a way as to include a "beneficiary's bank", it was necessary to include paragraph (1) in this article to make it clear that article 5 does not apply to a beneficiary's bank.

Concept of acceptance

2. In the draft prepared by the Secretariat for the eighteenth session of the Working Group a number of

the substantive rules depended on the acceptance of a payment order by the receiving bank. Discussion at that session showed that the Working Group was strongly divided on the desirability of using such a concept. Its use was advocated as a convenient means to describe in a single word a number of different actions of different receiving banks that should have the same legal consequences, making it possible to use the word in various substantive provisions. In response, it was said that use of the term "acceptance" was not necessary and that it would cause difficulties in many legal systems because it seemed to suggest that a contract was created as a result of the receiving bank's actions.

3. In order to help resolve the controversy, the Secretariat prepared a report for the nineteenth session of the Working Group that described the criteria for determining when a receiving bank had accepted a payment order and the consequences of acceptance (A/CN.9/WG.IV/WP.42, paras. 2 to 42). The matter was discussed at length by the Working Group at its nineteenth session, at the conclusion of which the Working Group decided to retain the use of the concept (A/CN.9/328, para. 52).

4. A proposal was made at the twentieth session to define the term "acceptance". The proposal received no support (A/CN.9/329, paras. 112 and 113).

Paragraph (2)

5. At the twenty-first session, when it made its decision that the credit transfer was completed when the beneficiary's bank accepted the payment order addressed to it, with the legal consequences that followed, "the Working Group did not exclude the possibility that it would reconsider the issue of acceptance of a payment order as it was set forth in articles 5 and 7 . . ." (A/CN.9/341, para. 17).

Subparagraph (a)

6. The current text of subparagraph (a) was adopted at the twentieth session (A/CN.9/329, paras. 123 and 175). It is fundamentally a combination of paragraphs (1) and (2)(a) of the text as it emerged from the nineteenth session (A/CN.9/328, annex). Paragraph (1) of that text was in turn composed of elements that had been in articles 5(1) and 7(1) of the text that had emerged from the eighteenth session (A/CN.9/318, annex). Throughout these various forms of presentation the basic policy, first established at the eighteenth session, has remained unchanged.

7. Except for certain obligations of notification of error set out in articles 6 and 8, the receiving bank is normally not required to act upon a payment order it receives unless it accepts the order. Nevertheless, the expectation is that a receiving bank will execute a payment order it has received. Therefore, if the receiving bank does not accept the order, paragraph (3) provides that it is required to notify the sender of the rejection. (See comments 16 to 20.) If the required notice of rejection is not given, paragraph (2)(a) provides that the payment order is accepted.

8. One of the most difficult issues has been whether the receiving bank should have an obligation to give a notice

of rejection when the reason that it has not executed the payment order is that it has not as yet received payment for it from the sender. In favour of such an obligation is that a notice of rejection informs a good faith sender that there is a problem that needs to be rectified, a problem that otherwise may be unknown. Failure to rectify the problem may have adverse consequences for the sender, for the originator, if the sender is not the originator, and for the beneficiary. Opposed to such an obligation of notification is the fact that in most cases the failure to receive payment is in fact only a technical delay that is automatically rectified. A notification of rejection, or even of non-receipt of payment without specifying that rejection will follow, will merely add to the message flow between banks and will itself lead to additional confusion. In any case, a sender is expected to know whether it has made adequate provision for paying the receiving bank, whether by debit of an account of the sender with the receiving bank or by credit of an account of the receiving bank with the sender or with a third bank.

9. The Working Group decided at the eighteenth session that the receiving bank should have no obligation to give the notice of rejection (the notice now called for by paragraph (3)) if one of its reasons for rejecting the payment order was insufficient funds (A/CN.9/318, para. 119). This led to discussions at the nineteenth and twentieth sessions as to what constituted insufficient funds, and whether any distinctions should be made between the different reasons why the funds were insufficient (A/CN.9/328, para. 15 and A/CN.9/329, paras. 119 to 122). The result was that the reference to insufficient funds was deleted from what is now paragraph (3) (A/CN.9/329, paras. 123 and 175). Paragraph (2)(a) was amended to provide that even if a required notice of rejection was not given, the payment order is not accepted "until the receiving bank has received payment from the sender in accordance with article 4(4)." See comments 17 to 19 as to when a notice of rejection is required and comments 31 to 45 to article 14 as to when payment has been received.

10. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested the deletion of the words "in accordance with article 4(4)". It noted that those words gave rise to a circular problem since article 4(4) provides that the sender is obligated to pay the receiving bank only when the receiving bank accepts the payment order. The sender is always permitted to pay the receiving bank prior to acceptance, which is the situation envisaged in article 5(2)(a). See also the suggestion in respect of paragraph (3) in comment 19.

Subparagraph (b)

11. Paragraph 2(b) was originally in prior article 6(2)(a) and was applicable only to the beneficiary's bank. At the eighteenth session of the Working Group it was decided that the provision should be modified by adding to it a requirement that the beneficiary's bank had exhibited a volitional element before the beneficiary's bank was deemed to have accepted the payment order (A/CN.9/318, para. 137). However, the required volitional element was not added to the text at that session. At the nineteenth

session of the Working Group the original provision was discussed at length in the context of the beneficiary's bank (A/CN.9/328, paras. 45 to 49). In favour of retaining the original text without any volitional element it was stated that contracts between banks that the receiving bank would execute payment orders when received even if funds were not yet available existed both in regard to multilateral net settlement systems and bilateral banking relations. They were entered into to increase the security of the operation of the funds transfer system. The legal security provided by those contractual obligations would be increased if the receiving bank was considered to have accepted the payment order as soon as it was received.

12. At the conclusion of the discussion at the nineteenth session it was decided to retain the original text as it applied to the beneficiary's bank and to extend the rule to receiving banks that were not the beneficiary's bank (A/CN.9/328, paras. 32 and 49; see also A/CN.9/329, para. 126 where a technical amendment was made).

Subparagraph (c)

13. Paragraph 2(c) providing that a receiving bank might expressly accept a payment order was added by the Working Group at its nineteenth session (A/CN.9/328, paras. 29 to 31). In the discussion doubts were raised as to the likelihood that a receiving bank would expressly accept a payment order for future implementation, but it was suggested that in the case of a large transfer a bank might be asked whether it would be prepared to handle the transaction. Its agreement would function as an express acceptance of the order.

Subparagraph (d)

14. Paragraph 2(d) provides for the normal way in which a receiving bank that is not the beneficiary's bank would accept a payment order it had received, i.e., by sending its own payment order intended to carry out the payment order received. If the payment order sent is consistent with the payment order received, the undertaking of obligations by the receiving bank and the execution of the most important of those obligations under article 6(2) are simultaneous. However, a receiving bank accepts a payment order even when it sends its own order for the wrong amount, to an inappropriate bank or for credit to the account of the wrong beneficiary, so long as the payment order sent was intended to carry out the payment order received. If such an inconsistent payment order is sent, the undertaking of obligations and the failure to carry out those obligations are also simultaneous.

15. *Comparison with Article 4A.* Article 4A-209(a) provides that "a receiving bank other than the beneficiary's bank accepts a payment order when it executes the order". Such a receiving bank executes the order, according to Article 4A-301(a), "when it issues a payment order intended to carry out the payment order received by the bank". That is the only way in which such a receiving bank can accept a payment order. If a notice of rejection is not given "despite the existence on the execution date of a withdrawable credit balance in an authorized account

of the sender sufficient to cover the order", Article 4A-210(b) provides that the bank is obliged to pay interest to the sender on the amount of the order, but that failure to give notice of rejection does not constitute acceptance of the order. Article 4A-211(d) provides that "An unaccepted payment order is cancelled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution date or payment date of the order". If a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, Article 4A-212 provides that it is liable for breach of the agreement.

Paragraph (3)

16. The text of article 7(4) following the eighteenth session of the Working Group provided that "a notice that a payment order will not be accepted must be given on the day the decision is made, but no later than the day the receiving bank was required to execute the order" (A/CN.9/318, annex). The drafting group at the nineteenth session moved the rule as to when the notice must be given by a receiving bank that is not the beneficiary's bank to article 5(1). In conformity with a decision of the Working Group it deleted the requirement that the notice must be given on the day the decision is made (A/CN.9/328, para. 86). At the twentieth session the requirement that a notice of rejection must be given was moved by the drafting group to article 5(3).

17. Paragraph (3) now provides that, if the receiving bank does not accept the payment order under paragraph (2)(b), (c) or (d), it must give a notice of rejection and that notice of rejection must be given by the execution date. If no required notice of rejection is given, paragraph (2)(a) provides that the receiving bank accepts the payment order. The provision should be understood to require the notice to be given by an expeditious means, which would normally mean by telecommunications.

18. The need to give notice of rejection exists even if the sender has no account relationship with the receiving bank or has even had no prior dealings with it of any kind (A/CN.9/318, paras. 114 to 116; A/CN.9/329, para. 118). There is no requirement that the notification give any reason for the rejection of the payment order (A/CN.9/297, para. 51).

19. No notice of rejection need be given if there is insufficient information to identify the sender (A/CN.9/329, para. 117). Furthermore, paragraph (3) appears to provide, by referring to paragraph (2)(a), that a receiving bank that had not yet received payment for the payment order need not give a notice of rejection. That would be contrary to what was decided at the twentieth session (A/CN.9/329, para. 123). In order to avoid that difficulty, in a communication to the Secretariat subsequent to the twenty-first session, the delegation of the United Kingdom has suggested the deletion of the words "otherwise than by virtue of subparagraph (2)(a)" and the addition of the following sentence:

"Where a receiving bank has failed to give notice of rejection within the time required by this paragraph, but under subparagraph (2)(a) the payment order is not

accepted because the receiving bank has not received funds from the sender, the receiving bank is not required to give notice of such non-acceptance, but remains liable for its original failure."

20. The text of article 5(1) following the eighteenth session of the Working Group stated that the obligation of the receiving bank to notify the sender of its decision that it would not comply with the sender's payment order was subject to the contrary agreement of the sender and receiving bank. Although the drafting group deleted those words from the current text, the deletion did not indicate a change in policy on the part of the Working Group. At the twentieth session the Working Group took note of the above statement, which had originally been made in A/CN.9/WG.IV/WP.44, comment 9 to article 5 (A/CN.9/329, para. 124). At the twenty-first session the Working Group adopted article 16, which gives the parties the power to vary any provision of the Model Law, unless specifically provided otherwise in the provision itself.

21. *Comparison with Article 4A.* As indicated in comment 15, although Article 4A does not require a notice of rejection, Article 4A-210(b) requires the receiving bank to pay interest to the sender if the bank fails to execute the order or give notice of rejection "despite the existence on the execution date of a withdrawable credit balance in an authorized account of the sender sufficient to cover the order". While the provision applies whether the sender is a bank or not, it seems to be intended to apply primarily when the sender is a non-bank originator. No rule is given when the receiving bank has received payment in some other way but fails either to execute the order or to give notice of rejection.

Article 6. Obligations of receiving bank that is not the beneficiary's bank

(1) The provisions of this article apply to a receiving bank that is not the beneficiary's bank.

(2) A receiving bank that accepts a payment order is obligated under that payment order to issue a payment order, within the time required by article 9, either to the beneficiary's bank or to an appropriate intermediary bank, that is consistent with the contents of the payment order received by the receiving bank and that contains the instructions necessary to implement the credit transfer in an appropriate manner.

(3) When a payment order is received that contains information which indicates that it has been misdirected and which contains sufficient information to identify the sender, the receiving bank shall give notice to the sender of the misdirection, within the time required by article 9.

(4) When an instruction does not contain sufficient data to be a payment order, or being a payment order it cannot be executed because of insufficient data, but the sender can be identified, the receiving bank shall give notice to the sender of the insufficiency, within the time required by article 9.

(5) If there is an inconsistency in a payment order between the words and figures that describe the amount

of money, the receiving bank shall, within the time required by article 9, give notice to the sender of the inconsistency, if the sender can be identified. This paragraph does not apply if the sender and the bank have agreed that the bank would rely upon either the words or the figures, as the case may be.

(6) The receiving bank is not bound to follow an instruction of the sender specifying an intermediary bank, funds transfer system or means of transmission to be used in carrying out the credit transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would cause excessive costs or delay in completion of the credit transfer. The receiving bank acts within the time required by article 9 if, in the time required by that article, it enquires of the sender as to the further actions it should take in light of the circumstances.

(7) For the purposes of this article, branches of a bank, even if located in the same State, are separate banks.

Prior discussion

A/CN.9/317, paras. 62 to 67 and 88
A/CN.9/318, paras. 60 to 69, 121, 122 and 144 to 154
A/CN.9/328, paras. 17 to 20 and 75
A/CN.9/329, paras. 128 to 141

Comments

Paragraph (2)

1. Paragraph (2) is prior paragraph (4), drafted in essentially the current form as article 5(3)(a) at the eighteenth session (A/CN.9/318, paras. 152 and 154) and redrafted by the drafting group at the nineteenth session. The paragraph states the basic obligation of a receiving bank other than the beneficiary's bank that has accepted a payment order, i.e., to send its own proper order to an appropriate bank within an appropriate period of time. On most occasions when a receiving bank is held liable to its sender it will be for failure to comply with the requirements of this paragraph. When the receiving bank sends its own payment order to its receiving bank, it becomes a sender and undertakes the obligations of a sender under article 4.

2. *Comparison with Article 4A.* Article 4A-302(a)(1) is essentially the same in substance.

Paragraph (3)

3. Paragraph (3) is based on paragraph (2) as it emerged from the nineteenth session (A/CN.9/328, annex), which in turn was based on the first sentence of article 5(1 *bis*) as it was adopted at the eighteenth session (A/CN.9/318, annex).

4. The Working Group decided at its eighteenth session that a receiving bank should be required to notify the sender when the payment order received indicated that it had been misdirected. The imposition of such a duty will help assure that the funds transfer system will function as intended (A/CN.9/318, para. 122). The duty applies

whether or not the sender and the receiving bank have had any prior relationship, whether or not the receiving bank accepted the order and whether or not the bank recognized that the payment order had been misdirected (see A/CN.9/328, para. 18).

5. As the result of a concern expressed at the nineteenth session that the bank might not be able to fulfil its obligation even if it wished to, paragraph (3) was modified to provide that the receiving bank is required to notify the sender only if the payment order "contains sufficient information to identify and trace the sender" (A/CN.9/328, para. 20). The words "and trace" were deleted at the twentieth session (A/CN.9/329, annex).

6. Paragraph (3) was retained at the twentieth session in spite of the argument that an excessive burden was being placed on the receiving bank, especially when the error was that of the sender (A/CN.9/329, paras. 129 to 131). In particular, it was said that when modern means of transmitting payment orders were used, the addressing of the payment order was done primarily by bank identification number and not by name.

7. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested that the present wording did not seem to implement the policy expressed at the twentieth session that the Model Law should not set forth a duty to detect the misdirection but that it was appropriate to require notification once the misdirection had been detected (A/CN.9/329, para. 130). It suggested the following wording to implement the policy there stated:

"(3) A receiving bank that detects that a payment order contains information which indicates that it has been misdirected shall give notice to the sender, if the payment order contains sufficient information to identify the sender, within the time required by article 9."

8. In accord with its suggested provision submitted to the Secretariat subsequent to the twenty-first session in respect to the existence of a procedure designed to detect errors, the delegation of the United Kingdom suggested the addition of the following sentence to its previous proposal:

"If the receiving bank has agreed with the sender that the payment order will be subject to a procedure to determine whether it has been misdirected and the sender complies with the procedure, the bank shall be taken to have detected any such misdirection if it would have done so had it also complied with the procedure."

9. The United Kingdom delegation further noted that, if a payment order was received with an execution date some time in the future, the fact that it had been misdirected might not be discovered on the date of receipt. It suggested an amendment to article 9(2) (see article 9, comment 10) that would read as follows:

"A notice required to be given under article 6(3) shall be given by the close of business on the day following the day of detection."

10. The United Kingdom delegation further suggested that it should be possible to contract out of the duties imposed by paragraph (3). It noted that agreements between banks often provide that a bank can rely on certain elements of a payment order; they agree that notification is not required even where a discrepancy that is discovered indicates that the payment order might have been misdirected. Effectively the sender is agreeing to bear the risk. The following wording was suggested to be added to the paragraph:

"This paragraph does not apply if the sender and the receiving bank have agreed that the bank would rely on only certain elements of the payment order."

11. It may be noted that the proposed text would not give as broad a freedom of contract as does article 16, a provision that did not yet exist when the suggestion of the United Kingdom was sent to the Secretariat.

12. *Comparison with Article 4A.* Article 4A-208(b)(4) provides that "if the receiving bank knows that the name and number identify different persons", (person here means intermediary or beneficiary's bank) reliance on either one is a breach of the bank's obligations. That provision is more positive than is the Model Law in authorizing a receiving bank to rely on identification of another bank by number alone.

Paragraph (4)

13. Paragraph (4) was added at the twentieth session (A/CN.9/329, para. 132) to cover a situation that did not fall within the scope of the already existing provisions requiring notice when a message is received that purports to be a payment order but that cannot be executed as such.

14. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested that the provision as drafted presented two difficulties. First, the Model Law applies only if there is a payment order. Therefore, logically it could not apply to a message that did not meet the definition of a payment order. Secondly, and of greater importance, it was suggested that the provision was too widely drawn because it covered an instruction regardless of whether the receiving bank appreciated that the provision applied. The following wording was suggested:

"(4) When an instruction is received that appears to be intended to be a payment order but that does not contain sufficient data to be a payment order or, being a payment order, cannot be executed because of insufficient data, but the sender can be identified, the receiving bank shall give notice to the sender of the insufficiency, within the time required by article 9."

15. *Comparison with Article 4A.* There is no equivalent provision in Article 4A, but the same result might be reached in some instances through Article 4A-208(b).

Paragraph (5)

16. Paragraph (5) as adopted at the twentieth session (A/CN.9/329, annex) is essentially the same as paragraph (3)

as adopted at the nineteenth session (A/CN.9/328, annex), which in turn was identical to article 3(1) as it was adopted at the eighteenth session (A/CN.9/318, paras. 60 to 69). If the amount is expressed in both words and figures and there is a discrepancy, the receiving bank is required to notify the sender. The obligation to notify exists whether or not the receiving bank has accepted the payment order. If the receiving bank does not give the required notice and it acts upon the incorrect amount, it is responsible for the consequences, even if it had no knowledge of the discrepancy.

17. At the twentieth session arguments were presented in favour of the rule that, in case of discrepancy, the traditional banking rule should be applied that words controlled over numbers (A/CN.9/329, paras. 133 to 135). Other arguments were presented in favour of the opposite rule that, in regard to modern electronic means of transmitting payment orders where the orders were processed by number, the numbers should control the words. Both arguments were rejected on the grounds that the current rule was a compromise and if a bank did process payment orders by number only, it could contract with its customers to that effect.

18. The rule is expressed in general terms to apply to payment orders between any sender and receiving bank. However, it was the expectation in the Working Group that paragraph (5) would apply in fact only between the originator and the originator's bank, since interbank payment orders in electronic form transmit the amount of the transfer in figures only (A/CN.9/318, paras. 61 and 63).

19. The view was expressed in the twentieth session that the paragraph was too restricted in that the amount might be represented in clear text by numbers but might also be part of a code, as a result of which the conflict might be between two sets of numbers (A/CN.9/329, para. 134). The suggestion was made that the reference should be only to a discrepancy in amount without saying how that discrepancy might appear. That suggestion was not implemented by the drafting group at the twentieth session.

20. *Comparison with Article 4A.* There is no equivalent provision in Article 4A. In some cases Article 4A-205 governing the security procedure for the detection of error would be applicable.

Paragraph (6)

21. Although a receiving bank is normally bound to follow any instruction in the payment order specifying an intermediary bank, funds transfer system or means of transmission, it can happen that it is not feasible to follow the instruction or that doing so would cause excessive costs or delay in completing the transfer (A/CN.9/328, para. 75). This paragraph gives the receiving bank an opportunity to make such a determination, so long as it does so in good faith (see other suggestions at A/CN.9/329, para. 139).

22. As an alternative, the receiving bank can enquire of the sender as to the actions it should take, but it must do so within the time required by article 9. In a communication

to the Secretariat subsequent to the twentieth session of the Working Group the delegation of the United Kingdom suggested that the second sentence did not clearly state that a receiving bank would not be in breach of article 9 if it enquired of the sender in the time specified in article 9. It suggested that the second sentence might read:

"A receiving bank that is required to take action by a time specified in article 9 shall be taken to have done so if, within that time, it enquires of the sender as to the further actions it should take in the light of the circumstances."

23. *Comparison with Article 4A.* Article 4A-302(b) contains essentially the same rule as does paragraph (6), except that a receiving bank may not choose an intermediary bank other than the one specified in the payment order received.

Article 7. Acceptance or rejection by beneficiary's bank

(1) The beneficiary's bank accepts a payment order at the earliest of the following times:

(a) when the time within which a required notice of rejection should have been given has elapsed without notice having been given, provided that acceptance shall not occur until the beneficiary's bank has received payment from the sender in accordance with article 4(4),

(b) when the bank receives the payment order, provided that the sender and the bank agreed that the bank will execute payment orders from the sender upon receipt,

(c) when it notifies the sender of acceptance,

(d) when the bank credits the beneficiary's account or otherwise places the funds at the disposal of the beneficiary,

(e) when the bank gives notice to the beneficiary that it has the right to withdraw the funds or use the credit,

(f) when the bank otherwise applies the credit as instructed in the payment order,

(g) when the bank applies the credit to a debt of the beneficiary owed to it or applies it in conformity with an order of a court.

(2) A beneficiary's bank that does not accept a sender's payment order, otherwise than by virtue of subparagraph (1)(a), is required to give notice to the sender of the rejection, unless there is insufficient information to identify the sender. A notice of rejection of a payment order must be given not later than on the execution date.

Prior discussion

A/CN.9/297, paras. 46 to 51

A/CN.9/317, paras. 80 to 84

A/CN.9/318, paras. 110 to 120 and 135 to 143

A/CN.9/WG.IV/WP.42, paras. 32 to 42 and 59 to 65

A/CN.9/328, 44 to 51, 59 and 60

A/CN.9/329, paras. 142 to 147

A/CN.9/341, para. 53

Error in text in A/CN.9/341, annex

In subparagraph (1)(a) as it appears in A/CN.9/341, annex the words "receiving bank" have been used rather than "beneficiary's bank", as is here used.

Comments

1. As a result of the restructuring of the draft Model Law by the drafting group at the nineteenth session of the Working Group, the provisions on the acceptance or rejection of a payment order by the beneficiary's bank were placed in an article separate from that containing similar provisions in respect of a receiving bank that is not the beneficiary's bank. The changes made to article 5 at the twentieth session were also introduced into article 7. Consequently, the majority of the provisions are identical, with the exception of the way in which the bank is referred to, and the comments to article 5 relative to use of the concept of acceptance and to paragraphs (2)(a), (b), (c) and (3) are applicable to article 7(1)(a), (b), (c) and (2).

2. Paragraph 1(c), (d), (e), (f) and (g) represents various forms of volitional act by the beneficiary's bank to accept the payment order received by it. Subparagraphs (d) to (g) were carried over from article 6(2) as adopted at the eighteenth session (A/CN.9/318, annex). At the twentieth session a suggestion was made, but was not acted upon, that subparagraphs (d) to (g) could be replaced by words to the effect "when the beneficiary's bank placed the funds at the disposal of the beneficiary" (A/CN.9/329, paras. 143 and 147).

3. At the nineteenth session the Working Group deleted from what is currently paragraph (1)(d) the words that had been in square brackets "[without reserving a right to reverse the credit if cover is not furnished]" (A/CN.9/328, para. 49). Those words recognized a practice in some countries to allow a receiving bank, including a beneficiary's bank, to give the credit party provisional credit awaiting the receipt of cover from the sending bank. (Compare last sentence of comment 7.)

4. The discussion at the nineteenth session recognized that the granting of provisional credit to the credit party had the advantage of making the processing of credit transfers more efficient in the vast majority of cases in which cover arrived at an appropriate time. Since the receiving bank was never required to grant provisional credit as a matter of law, it would do so only where it made the credit judgment that it was highly likely to receive the cover or that, if it did not, it could recover the provisional credit from the credit party. Such a credit judgment might be reflected in an agreement with a credit party to grant such provisional credit. Such an agreement would always authorize the receiving bank to reevaluate its decision to grant provisional credit, although the bank might be required to give advance notice of its decision that it would no longer do so.

5. The discussion at the nineteenth session also noted that the possibility that provisional credit might be reversed introduced elements of insecurity into the funds transfer system that affected not only the credit party, but in extreme cases might endanger the functioning of the entire system. Therefore, the Working Group decided that it was undesirable for a receiving bank, including the beneficiary's bank, to be allowed to reverse a credit (A/CN.9/328, paras. 59 to 60).

6. In an associated discussion at the nineteenth session the Working Group engaged in a preliminary discussion of the desirability of introducing a provision on netting into the Model Law (A/CN.9/328, paras. 61 to 65). A discussion of netting as it might affect the Model Law is to be found in comments 34 to 44 of article 4.

Comparison with Article 4A

7. Article 4A-209 makes a larger distinction than does the Model Law between the events leading to acceptance of a payment order by the beneficiary's bank and the events leading to acceptance of an order by any other receiving bank. Article 4A-209(b)(1) is substantially equivalent to subparagraphs (c) through (g) of this article. Article 4A-209(b)(2) and (3) base the acceptance of a payment order on when the beneficiary's bank is paid for the order, i.e., when it receives credit in its account at the Federal Reserve Bank, receives final settlement through a funds transfer system (e.g., CHIPS) or "the opening of the next funds-transfer business day of the bank following the payment date of the order if, at that time, the amount of the sender's order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless . . ." The "unless" clause introduces the possibility of rejection of a payment order by the beneficiary's bank. Rejection of a payment order by the beneficiary's bank is not possible when the bank receives the order through FEDWIRE. In the case of CHIPS, and as far as Article 4A is concerned, the beneficiary's bank can reject a payment order until it has accepted the order in one of the ways indicated above. Under Article 4A-405(d) and (e) it is possible for a beneficiary's bank to reverse its acceptance of a payment order if a net settlement system is unable to complete the settlement.

Article 8. Obligations of beneficiary's bank

(1) The beneficiary's bank is, upon acceptance of a payment order received, obligated to place the funds at the disposal of the beneficiary in accordance with the payment order and the applicable law governing the relationship between the bank and the beneficiary.

(2) When a payment order is received that contains information which indicates that it has been misdirected and which contains sufficient information to identify the sender, the beneficiary's bank shall give notice to the sender of the misdirection, within the time required by article 9.

(3) When an instruction does not contain sufficient data to be a payment order, or being a payment order it cannot be executed because of insufficient data, but

the sender can be identified, the beneficiary's bank shall give notice to the sender of the insufficiency, within the time required by article 9.

(4) If there is an inconsistency in a payment order between the words and figures that describe the amount of money, the beneficiary's bank shall, within the time required by article 9, give notice to the sender of the inconsistency, if the sender can be identified. This paragraph does not apply if the sender and the bank have agreed that the bank would rely upon either the words or the figures, as the case may be.

(5) Where the beneficiary is described by both words and figures, and the intended beneficiary is not identifiable with reasonable certainty, the beneficiary's bank shall give notice, within the time required by article 9, to its sender and to the originator's bank, if they can be identified.

(6) The beneficiary's bank shall on the execution date give notice to a beneficiary who does not maintain an account at the bank that it is holding funds for his benefit, if the bank has sufficient information to give such notice.

Prior discussion

A/CN.9/317, paras. 62 to 67 and 89 to 92
A/CN.9/318, paras. 64, 66 and 156 to 159
A/CN.9/328, paras. 17 to 20
A/CN.9/329, paras. 148 to 167

Comments

Paragraph (1)

1. The Working Group discussed at its nineteenth and twentieth sessions the issue of the extent to which the Model Law should be concerned with the relationship between the beneficiary and the beneficiary's bank (A/CN.9/328, paras. 37 to 43; A/CN.9/329, paras. 151 to 159; see A/CN.9/WG.IV/WP.42, paras. 58 to 68). The majority of the discussion at the nineteenth session related to the extent to which the Model Law should have rules in respect to the civil consequences of the credit transfer as in current article 14, but the discussion was generally relevant to the question as to whether the Model Law should include rules on the obligation of the beneficiary's bank to the beneficiary in respect of the credit transfer. At the conclusion of the discussion at the nineteenth session the Working Group decided to defer any decision on the question until it had discussed the time when acceptance took place. It returned to the question at the twentieth session at which time the current text was adopted.

2. Paragraph (1) provides only that the funds must be placed at the disposal of the beneficiary in accordance with the payment order and the applicable law governing the relationship between the bank and the beneficiary. The paragraph serves primarily as a reminder that the ultimate purpose of a credit transfer is to make funds available to the beneficiary.

3. A proposal to include a more detailed statement of the obligations of the beneficiary's bank to the beneficiary

was rejected at the twentieth session (A/CN.9/329, paras. 151 to 153). The limited approach taken in paragraph (1) conformed to the general policy that the Model Law should set forth the rights and obligations of the parties up to the moment when the beneficiary's bank accepted the payment order. However, the Model Law should not enter into the account relationship between the beneficiary and the beneficiary's bank, including in respect of issues that are closely related to the credit transfer, such as whether the bank must give the beneficiary notice of receipt of the credit (A/CN.9/329, paras. 165 and 166; see comments 15 and 16 for the notice requirement when there is no account relationship).

4. Notice by the beneficiary's bank to the beneficiary that it has the right to withdraw the funds or use the credit (or any of the other actions set out in article 7(1)(c) to (g)) would constitute acceptance of the payment order, if the payment order had not already been accepted in some other manner. To that extent the Model Law gives legal significance to the notice, in addition to any legal significance it may have under other applicable rules of law. However, the Model Law leaves it to those other applicable rules of law to determine the circumstances when notice might be required.

5. *Comparison with Article 4A.* Article 4A-404 specifies the obligation of the beneficiary's bank to pay to the beneficiary the amount of an order it has accepted. If the United States were to adopt the Model Law, Article 4A-404 would be the applicable law referred to in article 8(1).

Paragraphs (2), (3) and (4)

6. The restructuring of the text by the drafting group at the nineteenth and twentieth sessions of the Working Group led to the duplication in article 8(2), (3) and (4) of the text of article 6(3), (4) and (5) with appropriate changes in the references to the relevant banks. Therefore, the comments to those paragraphs, including the references to Article 4A, are relevant to the corresponding paragraphs of article 8.

Paragraph (5)

7. Paragraph (5) applies only to a payment order received by the beneficiary's bank containing a discrepancy between the identification of the beneficiary in words and its identification in figures. No bank prior to the beneficiary's bank can be expected to have the information to be able to determine that such a discrepancy exists.

8. Any solution to the case envisaged presents substantial difficulties. While a discrepancy in the identification of the beneficiary may be the result of error, it may also be an indication of fraud. Rather than take the chance that the incorrect account would be credited, the Working Group decided that the transfer should be suspended and the beneficiary's bank should notify its sender and also the originator's bank, if they are identified on the payment order, of the discrepancy (A/CN.9/318, para. 64).

9. In order to reduce to a minimum the time during which the transfer is suspended, the notification to both

the sender and the originator's bank must be done within the time specified in article 9(2), i.e., on the day the payment order is received, subject to article 9(3) and (4). It is anticipated that within a reasonable time the beneficiary's bank would receive further instructions as to the proper identification of the beneficiary, or an indication that the transfer was fraudulent.

10. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested that banks be permitted to contract out of the notice obligation in paragraph (5) by adding the following words:

"This paragraph does not apply if the sender and the bank have agreed that the bank would rely either upon the words or figures."

11. The proposed text would not give as broad a freedom of contract as does article 16, a provision that did not yet exist when the suggestion of the United Kingdom was sent to the Secretariat.

12. The delegation of the United Kingdom also noted that paragraph (5) was the only notice provision to require that notice be given directly to the originator's bank. It suggested that if the reason for such a requirement was that a discrepancy in the manner of identifying the beneficiary was particularly indicative of fraud, such a requirement might be included in other notice provisions and particularly article 8(4). Furthermore, it suggested that in any event it seemed sensible to notify the originator's bank when the sender could not be identified.

13. The delegation of the United Kingdom also suggested that there seemed to be an overlap between paragraphs (3) and (5) and that they might be rationalized.

14. *Comparison with Article 4A.* Article 4A-207 governs the problems covered in article 8(5). The provision is too complex to be summarized adequately here, but in general the beneficiary's bank is permitted to rely upon the number alone.

Paragraph (6)

15. Any duty to notify a beneficiary who had an account with the beneficiary's bank could be left to their agreement or to the law applicable to the account relationship. Although the sender may have an interest that the beneficiary's bank notify the beneficiary of the credit, that interest is not recognized in the Model Law (A/CN.9/329, para. 165).

16. However, there is unlikely to be a rule in the law applicable to the account relationship as to the obligation of the beneficiary's bank to notify a beneficiary who had no account relationship with the bank that the funds were available. Such a duty is set out in paragraph (6), but it applies only if the beneficiary's bank has accepted the payment order and if the bank has sufficient information to give such notice (A/CN.9/329, paras. 165 and 166). Contrary to the rule in article 9(2) in respect of the time when other required notices must be given, the notice specified in this paragraph must be given on the execution

date (A/CN.9/329, para. 172; compare the notice requirement in articles 5(3) and 7(2), i.e., "not later than on the execution date").

17. *Comparison with Article 4A.* Article 4A-404(b) provides that notice of receipt of a payment order instructing payment to an account of the beneficiary must be given by midnight of the next day but that "If the payment order does not instruct payment to an account of the beneficiary, the bank is required to notify the beneficiary only if notice is required by the order". In both cases the obligation to give notice can be varied by agreement of the beneficiary or by a rule of a funds transfer system that is used in the transfer.

Beneficiary's right to reject credit transfer

18. At the twentieth session the Working Group decided that in principle the Model Law should provide that the beneficiary would have a right to reject the credit transfer (A/CN.9/329, para. 164). One of the participants was requested to prepare a text, which would deal with the time within which the beneficiary would be permitted to act and the costs of any credit transfer returning the funds. Although the participant did not submit a proposal, the following provision suggested for the consideration of the Working Group is inspired by an informal draft supplied by him:

"The beneficiary has the right to reject a credit transfer [even though the beneficiary's bank has accepted the payment order and even though the transfer was made to an appropriate account of the beneficiary] by notice to the beneficiary's bank before the close of the banking day following the day when the bank accepted the payment order, if

(a) the beneficiary's bank has not applied the credit in conformity with paragraphs (1)(f) or (g),

(b) the beneficiary's bank has not applied the credit to an obligation owed by the beneficiary to the bank,

(c) when the beneficiary rejects the transfer, there is a credit balance in the account of an amount at least as much as the amount of the transfer, and

(d) the beneficiary's bank is not precluded by reason of insolvency or otherwise from repaying the amount of the transfer to its sender."

19. The rejection by the beneficiary should be as soon as is feasible so as to reduce the risk to the originator. The beginning of the period during which the beneficiary might be permitted to reject the transfer could be when the beneficiary's bank accepts the payment order, when the beneficiary's bank credits the beneficiary's account or otherwise applies the credit, or when the beneficiary receives notice of the transfer. Although the most logical time from the point of view of the beneficiary would be when he receives notice of the transfer, the Model Law does not require that notice be given and banking law and practice vary greatly as to when notice might be given, or even whether notice of a transfer is given. The proposal suggests that the rejection should have to be given by the end of the banking day following the day the beneficiary

bank accepts the payment order. That is a very long period of time for high-speed, high-value credit transfers, but it is difficult to decide what might be an appropriate shorter time.

20. The proposal places several limitations on the beneficiary's right to reject the payment order. The credit must not already have been specifically applied. The credit must still be available in the sense that there is a sufficient credit balance in the account. There might be a sufficient credit balance in the account when the payment order is rejected even though there had earlier not been a sufficient balance because in the meantime other credits have been made to the account. Unless the credit has been specifically applied, the proposal does not attempt to trace the credit on a first-in, first-out or other such basis. The credit must still be available in the sense that the beneficiary's bank is in a position to repay the amount of the transfer to the sender. The beneficiary should not be able to place on the originator the risk that the beneficiary's bank has become insolvent after it has accepted a payment order for the beneficiary's benefit or that the outbreak of war or similar event reduces the value of the credit to the beneficiary's account.

21. Under article 11(b) the beneficiary's bank, like all receiving banks in the chain of the failed credit transfer, will have to refund to its sender the funds received from its sender.

22. *Comparison with Article 4A.* Article 4A has no provision allowing the beneficiary to reject a payment order by notifying the beneficiary's bank. Compare Article 4A-406(b) on the right of the beneficiary to refuse payment from the originator when the payment was made by a means prohibited by the contract of the beneficiary with respect to the obligation.

Obligation to make funds available on pay date

23. At the twentieth session the Working Group considered, but did not decide, the issue of whether the beneficiary's bank should have a duty either to its sender or to the originator to make funds available on a payment date specified on the payment order (A/CN.9/329, para. 167).

Article 9. Time for receiving bank to execute payment order and give notices

(1) A receiving bank is required to execute the payment order on the day it is received, unless

(a) a later date is specified in the order, in which case the order shall be executed on that date, or

(b) the order specifies a pay date and that date indicates that later execution is appropriate in order for the beneficiary's bank to accept a payment order and place the funds at the disposal of the beneficiary on the pay date.

(2) A notice required to be given under article 6(3), (4) or (5) or article 8(2), (3), (4) or (5) shall be given on the day the payment order is received.

(3) A receiving bank that receives a payment order after the receiving bank's cut-off time for that type of payment order is entitled to treat the order as having been received on the following day the bank executes that type of payment order.

(4) If a receiving bank is required to take an action on a day when it is not open for the execution of payment orders of the type in question, it must take the required action on the following day it executes that type of payment order.

(5) For the purposes of this article, branches of a bank, even if located in the same State, are separate banks.

Prior discussion

A/CN.9/297, paras. 65 to 68

A/CN.9/317, paras. 94 to 107

A/CN.9/328, paras. 76 to 91

A/CN.9/329, paras. 168 to 183

Comments

1. Following the discussion at the nineteenth session of the Working Group of the draft of prior article 7, which had been prepared by the Secretariat for the eighteenth session, a new draft was prepared by a small group (A/CN.9/328, para. 88). Following discussion of the draft late in the nineteenth session, the small group further revised the draft article for discussion at the twentieth session, taking into account the restructuring of the draft Model Law being undertaken by the drafting group (A/CN.9/328, paras. 89 to 91). Article 9 was further revised at the twentieth session.

Purpose of paragraph (1)

2. The purpose of paragraph (1) is to state the time within which a receiving bank must execute a payment order; it is not intended to state an obligation to execute the order.

Same day execution

3. The general rule stated in the *chapeau* to paragraph (1) is that a payment order is to be executed on the day the payment order is received.

4. The Working Group has at all times accepted the appropriateness of the general rule. Such a rule might not have been appropriate when credit transfers, including international credit transfers, were paper based. However, the vast majority of international credit transfers are currently transmitted by electronic means, and especially by on-line data transfer. In such an environment rapid execution by the receiving bank should normally be expected (A/CN.9/329, paras. 176 and 177).

5. Nevertheless, the rule is strict and it is necessary that it be mitigated by several supplementary provisions. The first, found in paragraph (1) itself, is that the payment order may indicate that later execution is intended, either by specifying a later execution date or by specifying a

payment date that indicates that later execution is appropriate.

6. The second is the general rule that a receiving bank is not required to execute any payment order it receives simply by virtue of its reception (article 5, comment 6). Therefore, the obligation to execute the payment order by a certain time arises only if the receiving bank has accepted the order pursuant to article 5(2) or 7(1). A particularly important application of this rule is that, since a bank does not accept a payment order for failure to give notice of rejection under article 5(2)(a) or 7(1)(a) "until the . . . bank has received payment from the sender in accordance with article 4(4)", a receiving bank that receives sufficient funds on a day later than the day the order is received and executes the payment order on that day is not in breach of its obligations under article 9(1). It would be in breach of those obligations if it had agreed with the sender that it would execute payment orders from the sender upon receipt, since in such situations the receiving bank would have accepted the payment order when the order was received (articles 5(2)(b) and 7(1)(b)).

7. The third mitigating rule, which is found in paragraph (3), recognizes that banks establish cut-off times for the processing of payment orders for same day execution. There may be different cut-off times for different types of payment orders, and a bank might establish its cut-off time for certain types of payment orders by adhering to the rules of a funds transfer system. Any order received after the cut-off time is treated as having been received the following day the bank executes that type of payment order. There is no limit on the discretion of a bank (or funds transfer system) in establishing a cut-off time, and it is not unusual for cut-off times to be as early as noon (A/CN.9/329, para. 178).

8. The fourth mitigating rule, which is found in paragraph (5), is that a branch of a bank, even if in the same State, is treated as being a separate bank for these purposes. Where the branches of a bank process payment orders on a decentralized basis, a payment order that is sent from one branch to a second branch requires the same amount of time to be executed at the branch as if the order was to be sent to a different bank (A/CN.9/328, para. 82).

Notices

9. According to paragraph (2), notices must be given on the day the payment order is received, except for the notices required by articles 5(3), 7(2) and 8(6). The notice by the beneficiary's bank to a beneficiary who does not maintain an account at the bank that it is holding funds for his benefit, required by article 8(6), must be given on the execution date.

10. In a communication to the Secretariat subsequent to the twentieth session in which the delegation of the United Kingdom suggested several changes to the notice provision in article 6(3) (see article 6, comments 8 to 11), it suggested that the time within which the notice that a payment order received had been misdirected, as required by article 6(3), might be too short. If a payment order was

received with an execution date considerably later than the date of receipt, the fact that it had been misdirected might not be discovered on the day of receipt. It suggested that article 9(2) should be amended as follows:

"A notice required to be given under article 6(3) shall be given by the close of business on the day following the date of detection."

11. The delegation of the United Kingdom made a similar suggestion in regard to article 8(2) that it had made in regard to article 6(3). However, since the delegation was of the belief that the beneficiary's bank would generally verify whether it was the correct bank, a somewhat different wording was suggested as follows:

"A notice required to be given under article 8(2) shall be given by the close of business on the day following the date on which it was, or ought reasonably to have been, detected that the payment order contained information indicating that it had been misdirected."

Execution date

12. According to article 2(k), the execution date is the date when the receiving bank is to execute the payment order in accordance with article 9. The execution date may be any of three different dates. Normally the execution date is the day the payment order is received. If a later execution date is specified on the order, the execution date is that date. If a payment date is specified on the payment order, the execution date for a receiving bank other than the beneficiary's bank is the day that is appropriate in order for the beneficiary's bank to accept a payment order and place the funds at the disposal of the beneficiary on the payment date.

13. At the twentieth session the Working Group deferred to a future session the question whether any special time period would have to be given to an originator's bank that received a conditional payment order or whether the proper result would be achieved by an interpretation of paragraph (1) (A/CN.9/329, paras. 173 and 174). However, consideration of that question is no longer necessary following the decision of the Working Group at the twenty-first session that conditional payment order should not be considered to be payment orders under the Model Law (A/CN.9/341, para. 73).

14. If the receiving bank executes the order prior to the execution date, the payment order is accepted (articles 5(2)(d) and 7(2)(d)) and the sender would no longer have the possibility to revoke the order (article 10(1)(b) and (2)(b)). At the nineteenth session it was stated that the sender should not lose its power to revoke its payment order prior to the execution date even if the order had been prematurely executed by the receiving bank (A/CN.9/328, para. 78). However, no provision to that effect was introduced into the draft Model Law by the drafting group. The question was again raised at the twentieth session, where it was said that such a rule would have its most important effects in cases of insolvency. The Working Group decided to keep the issue in mind in its consideration of articles 10 and 12 (A/CN.9/329, paras. 168 and 169). In this regard it should be noted that the sender is

not required to pay the receiving bank until the execution date (article 4(4)).

15. If a provision were introduced into the Model Law permitting a sender to revoke its payment order until the execution date, the sender would presumably be entitled to recover any funds it had already paid the receiving bank and the right of the sender to recover funds from the beneficiary would be assigned to the bank (compare article 10(6) and (7)).

16. The receiving bank's failure to execute a payment order on the execution date would lead to liability under article 12. The receiving bank might execute the payment order late because the order was received late. Under the text of article 7(2) as it was adopted at the eighteenth session (A/CN.9/318, annex) the bank that received the order late complied with its obligations if it executed the order on the day received "regardless of any execution, value or pay date specified in the order". Although no objection was expressed to that paragraph at the nineteenth session (A/CN.9/328, paras. 81 and 82), the paragraph was not included in the article as it was restructured by the drafting group. At the twentieth session the Working Group decided that the substance of prior article 7(2) was currently covered in the *chapeau* of article 9 where it was stated that a receiving bank was required to execute the payment order on the day it was received (A/CN.9/329, para. 170).

Payment date

17. According to article 2(1) the payment date is "the date specified in the payment order when the funds are to be placed at the disposal of the beneficiary". (See comments 58 to 62 to article 2.) The payment date is of immediate importance in the payment order issued to the beneficiary's bank, since it is that bank that must place the funds at the disposal of the beneficiary. A payment date in a payment order sent to the beneficiary's bank functions as though it was the execution date.

18. In a communication to the Secretariat subsequent to the twenty-first session the delegation of the United Kingdom suggested that the expression "pay date" could be replaced by "date when the funds are to be placed at the disposal of the beneficiary". Unless the Working Group decided that the expression "payment date" was needed in article 12(4), the definition in article 2(1) could also be deleted.

Derogation by contract

19. In response to a suggestion made at the twentieth session that the sender and the receiving bank should be able to derogate from the provisions of paragraph (1) by agreement, it was stated that such a possibility would make it impossible for originator's banks to predict how long international credit transfers would take when they had to go through several intermediary banks (A/CN.9/329, para. 180). However, with the adoption of article 16 at the twenty-first session, the parties are free to derogate from any provision of article 9. If the Working Group should wish to reaffirm the policy stated at the twentieth

session for some or all of article 9, it would have to do so specifically

Comparison with Article 4A

20. Articles 4A-301(b) and 4A-302(a) in combination are substantially the same as paragraph (1). Since there are no notice requirements that are the equivalent of the ones referred to in paragraph (2), there are no time limits equivalent to paragraph (2). Article 4A-106 is the same as paragraphs (3) and (4). Article 4A-209(d) provides that a payment order issued to the originator's bank cannot be accepted until the payment date if the bank is the beneficiary's bank, or the execution date if the bank is not the beneficiary's bank.

Article 10. Revocation

(1) A revocation order issued to a receiving bank other than the beneficiary's bank is effective if:

(a) it was issued by the sender of the payment order,

(b) it was received in sufficient time before the execution of the payment order to enable the receiving bank, if it acts as promptly as possible under the circumstances, to cancel the execution of the payment order, and

(c) it was authenticated in the same manner as the payment order.

(2) A revocation order issued to the beneficiary's bank is effective if:

(a) it was issued by the sender of the payment order,

(b) it was received in sufficient time before acceptance of the payment order to enable the beneficiary's bank, if it acts as promptly as possible under the circumstances, to refrain from accepting the payment order, and

(c) it was authenticated in the same manner as the payment order.

(3) Notwithstanding the provisions of paragraphs (1) and (2), the sender and the receiving bank may agree that payment orders issued by the sender to the receiving bank are to be irrevocable or that a revocation order is effective only if it is received by an earlier point of time than provided in paragraphs (1) and (2).

(4) If a revocation order is received by the receiving bank too late to be effective under paragraph (1), the receiving bank shall, as promptly as possible under the circumstances, revoke the payment order it has issued to its receiving bank, unless that payment order is irrevocable under an agreement referred to in paragraph (3).

(5) A sender who has issued an order for the revocation of a payment order that is not irrevocable under an agreement referred to in paragraph (3) is not obligated to pay the receiving bank for the payment order:

(a) if, as a result of the revocation, the credit transfer is not completed, or

(b) if, in spite of the revocation, the credit transfer has been completed due to a failure of the receiving bank or a subsequent receiving bank to comply with its obligations under paragraphs (1), (2) or (4).

(6) If a sender who, under paragraph (5), is not obligated to pay the receiving bank has already paid the receiving bank for the revoked payment order, the sender is entitled to recover the funds paid.

(7) If the originator is not obligated to pay for the payment order under paragraph (5)(b) or has received a refund under paragraphs (5)(b) or (6), any right of the originator to recover funds from the beneficiary is assigned to the bank that failed to comply with its obligations under paragraphs (1), (2) or (4).

(8) The death, bankruptcy, or incapacity of either the sender or the originator does not affect the continuing legal validity of a payment order that was issued before that event.

(9) A branch of a bank, even if located in the same country, is a separate bank for the purposes of this article.

Prior discussion

A/CN.9/297, paras. 79 and 92 to 95
A/CN.9/317, paras. 68 and 120 to 133
A/CN.9/328, paras. 92 to 116
A/CN.9/329, paras. 184 to 186

Comments

1. Article 10 provides a framework for the revocation of payment orders after they have been received by the receiving bank. At the nineteenth session of the Working Group it was suggested that, since international credit transfers are almost always sent by on-line telecommunications and are processed by computer, there would be little opportunity for the sender to revoke the payment order before the order was executed by the receiving bank and that it was, therefore, unnecessary to have any provision on the subject. The reply was given that a revocation that did not arrive in time because of the use of high-speed electronic systems would not be effective. That was not, however, considered to be sufficient reason to preclude the originator or other sender from having the opportunity to attempt to revoke the order (A/CN.9/328, paras. 93 and 94).

2. The text presented to the nineteenth session of the Working Group had one set of rules that covered both the revocation and the amendment of payment orders. At the nineteenth session it was noted that the amendment of payment orders might raise additional policy issues to those raised by the revocation of orders (A/CN.9/328, para. 100). As a result article 10 refers only to the revocation of payment orders and no provision is made in the current draft for their amendment.

3. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested that the policy not to permit an amendment

of a payment order was not sufficiently clear in the text and that the following wording might be added to paragraph (2):

"A revocation order is not effective if it is expressed to cover part only of a payment order."

4. At the twentieth session the Working Group took note of a proposal that would terminate the right to revoke or amend a payment order once it had been received by the receiving bank, but which would also permit a receiving bank that was not the beneficiary's bank to cooperate with the request of the sender, regardless of whether or not the payment order had been accepted, or a beneficiary's bank to so cooperate if it had not already accepted the payment order (A/CN.9/329, paras. 184 to 186). However, no action was taken since it had been agreed that the discussion of article 10 at that session was to be only exploratory.

5. Also at the twentieth session the words "or a revocation of a payment order" were placed in square brackets in articles 2(j) and 4(1) because of opposition in the Working Group to the basic scheme of article 10 (A/CN.9/329, paras. 76 and 96).

Paragraphs (1) and (2)

6. Paragraphs (1) and (2) provide essentially the same rules for the revocation of a payment order sent to a receiving bank that is not a beneficiary's bank and to a receiving bank that is a beneficiary's bank. In both cases the revocation can be sent only by the sender of the payment order; neither the originator nor an earlier bank in the credit transfer chain can revoke the order even though it may be the party interested in having the order revoked. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested the addition of the words "or other person who had the authority to bind the sender" to both paragraphs (1)(a) and (2)(a).

7. In both cases the payment order can be revoked only if the revocation is received by the receiving bank in time. In the case of a receiving bank that is not the beneficiary's bank, the event that marks the termination of the right to revoke is the execution of the order by the receiving bank. Although the current draft of the Model Law does not define what constitutes execution of the order by the receiving bank, it can be assumed to be the sending of its own payment order intended to carry out the order received (compare article 5(2)(d) with article 6(2)). While sending its own order would also constitute acceptance of the order received, other forms of acceptance under article 5(2) would not constitute execution of the order received. In the case of the beneficiary's bank, the event that marks the termination of the right to revoke is the acceptance of the order by the bank in any of the ways described in article 7(1).

8. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested that paragraph (1)(b) should read as follows:

"(b) it was received in sufficient time to enable the receiving bank, if it acts as promptly as is reasonable

in all the circumstances, to refrain from executing the payment order, and"

while paragraph (2)(b) should read as follows:

"(b) it was received in sufficient time to enable the beneficiary's bank, if it acts as promptly as is reasonable in all the circumstances, to refrain from accepting the payment order, and".

9. The receiving bank is given a certain period of time to act upon the revocation received. This period must be "sufficient" to enable the bank "if it acts as promptly as possible under the circumstances," to cancel the execution of its own order or to refrain from accepting the order received, as the case may be. The length of the period as so defined is by its nature indefinite, since it depends on the ability of the receiving bank to act (A/CN.9/328, paras. 96 and 116). The time required will vary from one bank to another, indeed from one branch of a bank to another, and depend on the nature of the payment order and the means of communication of the revocation.

10. The revocation must be authenticated in the same manner as the payment order. This implies that the revocation must be sent by the same means of communication as was the payment order. When this wording was questioned at the nineteenth session of the Working Group, citing the case of a paper-based payment order that was revoked by a tested telex, the reply was given that an attempt had been made to draft a requirement that the authentication had to be as good as or better than the authentication of the payment order being revoked, but that it had not proven possible to do so (A/CN.9/328, para. 114).

11. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested that it would be desirable to add to the end of subparagraphs (1)(c) and (2)(c) the words "or as otherwise agreed by the sender and receiving bank".

12. At the nineteenth and twentieth sessions of the Working Group it was stated that the sender should not lose its power to revoke its payment order prior to the execution date even if the order had been prematurely executed by the receiving bank (A/CN.9/328, para. 78; A/CN.9/329, paras. 168 and 169; see article 9, comment 14).

13. *Comparison with Article 4A.* Article 4A-211 permits cancellation of a payment order, as well as its amendment, until the order has been accepted. A receiving bank that is not the beneficiary's bank can agree to cancel or amend an order it has received even after it has accepted the order, or can be bound to do so by a funds transfer system rule, but the bank must be able to cancel any order it has issued in execution of the order it received. A beneficiary's bank can agree, or be required by a funds transfer system rule, to cancel or amend an order that was issued in execution of an unauthorized payment order or was issued as a result of one of several types of error by the sender. Those provisions in Article 4A cover essentially the problems covered in paragraphs (1) to (4) of article 10.

Paragraph (3)

14. Paragraph (3) was introduced into the draft Model Law at the nineteenth session of the Working Group (A/CN.9/328, para. 98). Agreements restricting the right of a sender to revoke a payment order are common in multi-lateral payment arrangements, especially where there is delayed net settlement, and in batch processing systems where it may be difficult, if not impossible, to extract a single payment order from the batch. Paragraph (3) probably does not apply to a restriction in a telecommunications message system that prohibits the withdrawal of a message once sent. Even a telex cannot be withdrawn as a message from the public telecommunications system once it has been sent; however, the order contained in the message can be revoked under paragraph (1) or (2).

15. When paragraph (3) was introduced at the nineteenth session of the Working Group, concern was expressed over its effect since the originator might not know that there were agreements between particular banks through which the credit transfer might pass that made a payment order between those banks irrevocable (A/CN.9/328, para. 115). An agreement of a clearing-house, for example, through which the originator's bank sent the payment order to an intermediary bank that restricted the right to revoke the order would preclude the originator from revoking the credit transfer even though the beneficiary's bank had not yet accepted an order to carry out the transfer. That result is explicitly provided in paragraph (4).

16. At the twenty-first session the Working Group adopted article 16, which provides for a general freedom of contract "except as otherwise provided in this law". If the right to revoke a payment order as provided in article 10 is retained, the Working Group may wish to reconsider paragraph (3) in the light of article 16. In a communication to the Secretariat subsequent to the twenty-first session the delegation of the United Kingdom suggested that, if the paragraph is retained, it should begin "For the avoidance of doubt" instead of "Notwithstanding the provisions of paragraphs (1) and (2)", so as not to prejudice the generality of article 16.

Paragraph (4)

17. If a receiving bank has already issued its own payment order intended to carry out the payment order received, paragraph (4) provides that it shall revoke its own order to its receiving bank. The obligation is automatic and is not dependent upon the request of the sender, but it is dependent on there not being an agreement restricting the right of the receiving bank as a sender to revoke its own order as described in paragraph (3). The effectiveness of the revocation is tested under paragraph (1) or (2). The series of messages can go from bank to bank until a payment order is revoked or the beneficiary's bank is reached. The credit transfer can no longer be interrupted by revocation of a payment order once the beneficiary's bank has accepted an order implementing the transfer.

18. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom has suggested a redraft of paragraph (4) in which the

most important change would be that the revocation would have to be issued "as promptly as is reasonable in all the circumstances".

Paragraphs (5) and (6)

19. These two paragraphs specify that a sender who has sent a revocation that was or should have been effective is not obligated to pay for the payment order, as he would otherwise be under article 4(4), and is entitled to recover any funds paid. At the nineteenth session it was suggested that the sender should be entitled to receive back the original amount of the transfer less costs. This was said to be a question that arose in respect of the reimbursement of the funds in case of an unsuccessful credit transfer as well and that it would need to be addressed at a later stage (A/CN.9/328, para. 115). It may be thought that a sender who has a right to a refund under paragraph (6) should also have a right to interest on the funds for the period of time the sender was deprived of the use of those funds. Compare article 12, comments 25 to 35.

20. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested that paragraphs (5)(a) and (b) should be redrafted as follows:

"(a) if, as a result of the revocation, the payment order has not been accepted by the beneficiary's bank, or

(b) if, in spite of the revocation, the payment order has been accepted due to a failure of the receiving bank or a subsequent receiving bank to comply with its obligations consequent upon the operation of paragraphs (1) and (2) or under paragraph (4)."

21. The delegation of the United Kingdom also suggested the addition of the words "from the receiving bank" to the end of paragraph (6).

22. *Comparison with Article 4A.* Paragraphs (5) and (6) would seem to be covered by Article 4A-402(c) and (d), which in this respect are the equivalent of article 11(b).

Paragraph (7)

23. If a bank has executed a payment order in spite of receipt of an effective revocation, there is a likelihood that the funds will eventually be credited to the account of the beneficiary. Paragraph (7) gives the bank that made the error and was required to reimburse its sender the means to recover the funds by being assigned any right the originator may have had to recover the funds from the beneficiary.

24. Under some circumstances paragraph (7) will not give the bank the full protection that was anticipated and the originator may have an unjustified profit. Although the sender has a complete right to recover the funds from the bank that made the error under paragraph (6), the originator may not have a right to recover the funds from the beneficiary because it owed that amount to the beneficiary. The right assigned to the bank that made the error could be no greater than the right of the originator.

25. To some degree paragraph (7) is a replacement for article 8(7) as it was adopted at the eighteenth session (A/CN.9/318, annex), that was deleted by the Working Group at its nineteenth session (A/CN.9/328, para. 106). That provision would have given the beneficiary's bank a right to reverse a credit entered to the beneficiary's account that met certain objective criteria of being the result of an error or fraud. For the origin of prior article 8 see A/CN.9/297, para. 79 and A/CN.9/317, para. 68. The current text of paragraph (7) is severely restricted in its field of application compared to the earlier provision.

26. In order to avoid the problems mentioned in comment 24 and because the reference in paragraph (7) to paragraph (6) was said to be incorrect, since paragraph (6) refers to paragraph (5), and paragraph (7) cannot apply if subparagraph (5)(a) applies, the delegation of the United Kingdom in a communication to the Secretariat subsequent to the twentieth session suggested the following redraft:

"(7) If the originator has received a refund under paragraph (5)(b), the bank whose failure to comply with its obligations under paragraphs (1), (2) or (4) resulted in the completion of the credit transfer shall have such rights to recover from the beneficiary as the originator would have had if he had not received a refund. If the originator has not paid for his payment order and under paragraph (5)(b) is not obliged to do so, that bank shall have the same rights under this paragraph as if the originator had paid for the payment order and had received a refund."

27. *Comparison with Article 4A.* There is no directly equivalent provision in Article 4A. See, however, Article 4A-211(c)(2).

Paragraph (8)

28. In order to make the provision clearer and to assure that the word "bankruptcy" is not understood in a restricted sense (as in English law where it is restricted to personal insolvency), the delegation of the United Kingdom in a communication to the Secretariat subsequent to the twentieth session suggested the following revision:

"(8) The death, bankruptcy, or incapacity of either the sender or the originator does not, of itself, operate to revoke a payment order or terminate the authority of the sender. The word 'bankruptcy' includes all forms of personal and corporate insolvency."

29. It may be noted that article 52(1) of the United Nations Convention on International Bills of Exchange and International Promissory Notes treats a similar problem as follows:

"1. A necessary or optional presentment for acceptance is dispensed with if:

(a) The drawee is dead, or no longer has the power freely to deal with his assets by reason of his insolvency, or is a fictitious person, or is a person not having capacity to incur liability on the instrument as an acceptor; or

(b) The drawee is a corporation, partnership, association or other legal entity which has ceased to exist."

30. *Comparison with Article 4A.* Article 4A-211(g) provides that

"A payment order is not revoked by the death or legal incapacity of the sender unless the receiving bank knows of the death or of an adjudication of incapacity by a court of competent jurisdiction and has reasonable opportunity to act before acceptance of the order."

Paragraph (9)

31. This paragraph should be revised in line with the similar wording in the earlier articles.

New proposal

32. Former article 8(8) provided that a bank has no obligation to release the funds received if ordered by a competent court not to do so. When it deleted that paragraph at its nineteenth session the Working Group decided that it would consider a proposal that was to be presented authorizing courts to restrain a bank from acting on a payment order if proper cause was shown (A/CN.9/328, para. 109).

33. A proposal presented to the nineteenth session but not yet considered by the Working Group provided:

"For proper cause and in compliance with applicable law, a court may restrain:

(a) a person from issuing a payment order to initiate a funds transfer;

(b) an originator's bank from executing the payment order of the originator, or

(c) the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing funds.

A court may not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order, or otherwise acting with respect to a credit transfer, but a bank has no obligation if it acts in accordance with the order of a court of competent jurisdiction."

34. *Comparison with Article 4A.* The proposal is identical to Article 4A-503, except for the last clause which is additional.

CHAPTER III. CONSEQUENCES OF FAILED, ERRONEOUS OR DELAYED CREDIT TRANSFERS

Article 11. *[Assistance and refund]*

A receiving bank other than the beneficiary's bank that accepts a payment order is obligated under that order:

(a) where a payment order is issued to a beneficiary's bank in an amount less than the amount in the

payment order issued by the originator to the originator's bank—to assist the originator and each subsequent sending bank, and to seek the assistance of its receiving bank, to obtain the issuance of a payment order to the beneficiary's bank for the difference between the amount paid to the beneficiary's bank and the amount stated in the payment order issued by the originator to the originator's bank;

(b) where a payment order consistent with the contents of the payment order issued by the originator and containing instructions necessary to implement the credit transfer in an appropriate manner is not issued to or accepted by the beneficiary's bank—to refund to its sender any funds received from its sender, and the receiving bank is entitled to the return of any funds it has paid to its receiving bank.

Prior discussion

A/CN.9/318, paras. 151 to 154

A/CN.9/328, paras. 54 to 58

A/CN.9/341, para. 56

Comments

1. Article 11 sets forth the basic obligations of a receiving bank to rectify the situation if problems arise in the implementation of a credit transfer. It contains prior article 5(3)(b) and (c) as it was drafted during the eighteenth session (A/CN.9/318, para. 154) with the order of the two subparagraphs reversed. The drafting group at the nineteenth session could not decide on a proper title for this new article, so it placed the provisional title in square brackets. The article was not considered at the twentieth or twenty-first sessions.

Subparagraph (a)

2. The first obligation of a receiving bank when the credit transfer has not been successfully carried out is to take the necessary steps to cause it to be carried out. If the receiving bank is the cause of the difficulties, it would carry out its obligation under subparagraph (a) by taking the necessary actions itself. If the difficulties occurred at a subsequent bank in the credit transfer chain, the receiving bank would be obligated to assist in causing the transfer to be carried out properly by such actions as finding out where the problem had occurred or sending new instructions to the subsequent bank.

3. Subparagraph (a) was adopted at the eighteenth session of the Working Group and was not discussed at the nineteenth session. However, the drafting group at the nineteenth session made a minor change in the text by referring to the issuance of a payment order for an amount "less" than, rather than an amount "different" from, the amount in the originator's payment order. That change made the provision more precise but did not change its substantive application, since the prior wording could itself have been applied only when the payment order had been for less than the correct amount. Consideration might be given to extending the subparagraph to the case where no payment order has been issued to the beneficiary's

bank, a result that cannot be reached by interpretation of the current text.

4. *Comparison with Article 4A.* There is no equivalent provision in Article 4A.

Subparagraph (b)

5. Subparagraph (b) sets forth one of the most important rules in the draft Model Law; if the credit transfer is not carried out in a manner consistent with the payment order issued by the originator, the sender has a right to a refund of any funds it has paid to the receiving bank. This right ultimately accrues to the benefit of the originator as the sender of the first payment order in the credit transfer chain.

6. Two different situations are envisaged under subparagraph (b): no payment order was accepted by the beneficiary's bank (perhaps because none was issued to it) and a payment order was accepted but it was inconsistent with the originator's payment order in some manner other than that it was for too small an amount. Subparagraph (b) as drafted would also apply where the payment order was for too small an amount, but in such a case the subparagraph should normally apply only to the deficiency and only if subparagraph (a) does not remedy the situation. It might apply to the entire amount in the rare situation where the transfer of too small an amount rendered the transfer commercially valueless.

7. The reason a credit transfer is not carried out successfully may be that the indication of the beneficiary or of the beneficiary's bank was incorrect on one of the payment orders in the transfer chain by reason of error or fraud. Other reasons why a credit transfer may fail to be carried out successfully are that the imposition of currency restrictions prevents the transfer from being made, for some reason a transfer cannot be made to the beneficiary's bank or to the country where the beneficiary's bank is located, the beneficiary's bank refuses to accept the payment order addressed to it or the account of the beneficiary is no longer open to receive credit transfers. In most cases where the indication of the incorrect beneficiary or beneficiary's bank was the result of an error, it could be expected that the error would be corrected and the credit transfer would be carried out as directed, though perhaps late. If the credit to the beneficiary's account is for an amount greater than the amount specified in the originator's payment order, subparagraph (b) should be interpreted to permit the sender to recover the payment it had made in excess of the correct amount, and it might be desirable to say so explicitly.

8. Although the general policy decision made by the Working Group at its sixteenth session, and affirmed by it on several occasions, that the originator should be able to hold its bank responsible for proper performance of the credit transfer is still open to discussion (A/CN.9/297, paras. 55 to 60; see A/CN.9/328, paras. 66 to 74 and 144; A/CN.9/329, para. 188, question 4 and A/CN.9/341, para. 56), the application of that policy to the return of the principal sum where the credit transfer failed was strongly endorsed at the nineteenth session (A/CN.9/328, paras. 54

to 58). The obligation of the receiving bank is absolute and the exemptions of article 13 would not apply. At the eighteenth session the Working Group rejected a suggestion that the obligation of a receiving bank should be to assign to its sender the right of reimbursement it would have from its receiving bank (A/CN.9/318, para. 153). The result of that suggestion would have been to place on the originator the obligation to pursue its claim for reimbursement from a subsequent bank in the transfer chain and to bear the risk that the reimbursement could not be fully recovered. As it is, under article 11(b) if a credit transfer is not completed and any receiving bank is not able to reimburse its sending bank, perhaps because of the insolvency of the receiving bank or because of the cessation of payments between the two States concerned, the sending bank to that non-reimbursing receiving bank would bear the loss. Such a non-reimbursing receiving bank would normally be an intermediary bank. It would be the beneficiary's bank only if the bank had not accepted the payment order even though it had received payment for the order from its sender, a situation that would rarely arise.

9. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom suggested a revision of the article as follows:

"(1) If no payment order consistent with the payment order issued by the originator to the originator's bank and containing instructions necessary to implement the credit transfer in an appropriate manner is issued to the beneficiary's bank, each receiving bank shall:

(a) assist the originator and each subsequent sending bank, and seek the assistance of its receiving bank, to obtain the issue to the beneficiary's bank of a payment order which is so consistent and contains such instructions;

(b) refund to its sender any funds received from its sender for payment for the payment order, or, where excess funds are received, refund the excess.

(2) Paragraph (1)(b) also applies where a payment order is rejected by the beneficiary's bank."

10. In a communication to the Secretariat subsequent to the twenty-first session the delegation of the United Kingdom confirmed its belief that the beneficiary's bank should be included in article 11(b) as a bank that may have to return funds it has received. However, it now suggests that where the beneficiary's bank is no longer holding the funds, a further provision will be needed to limit the amount the beneficiary's bank is obligated to refund to the amount that is recoverable under the applicable law by the beneficiary's bank from the person to whom the funds have been paid.

11. At the nineteenth session a suggestion was made that the amount of the funds to be returned should be the original amount of the transfer less costs. It was said that this issue would have to be addressed at a later time (A/CN.9/328, para. 115). In line with the decision of the Working Group at the twenty-first session that article 14 should not purport to determine whether the originator or the beneficiary was ultimately responsible to pay the fees for the

transfer (A/CN.9/341, para. 20), the Working Group may believe that the question of the allocation of the costs of the transfer of the amount to be returned under article 11(b) should also not be determined by the Model Law.

12. At the twenty-first session it was stated that where the credit transfer was not completed and the sender of a payment order had the right to get his funds back under article 11(b), the sender should also be entitled to receive interest (A/CN.9/341, para. 118). Such a decision could be implemented by adding to the text of article 11(b) as proposed by the delegation of the United Kingdom as set out in comment 9 the words "with interest" following the words "return to its sender". See also comment 31 to article 12. The period of time for which the receiving bank would have to pay interest is not stated, but it should be understood to be from the date the bank received payment for the payment order from its sender to the date it returns the funds. If the receiving bank in question in turn sent the payment order to a subsequent receiving bank, it would have the right to the refund with interest for the time its receiving bank had the funds, thereby reducing its own final cost to the interest for the time that it was the holder of funds arising out of the failed transfer.

13. *Comparison with Article 4A.* Article 4A-402(c), (d) and (e) are the equivalent provisions. Paragraph (e) re-allocates the risk of loss arising out of the inability of an intermediary bank to return the funds because it is not permitted by applicable law or because the bank suspends payments when the sender to that bank acted in conformity with an instruction in the payment order it received. That provision is not contained in the Model Law.

Article 12. *Liability and damages*

(1) *Deleted*

(2) The originator's bank and each intermediary bank that accepts a payment order is liable to its sender and to the originator for the losses as set out in paragraph (5) of this article caused by the non-execution or the improper execution of the credit transfer as instructed in the originator's payment order. The credit transfer is properly executed if a payment order consistent with the payment order issued by the originator is accepted by the beneficiary's bank within the time required by article 9.

(3) An intermediary bank is not liable under paragraph (2) if the payment order received by the beneficiary's bank was consistent with the payment order received by the intermediary bank and the intermediary bank executed the payment order received by it within the time required by article 9.

(4) The beneficiary's bank is liable

(a) to the beneficiary for its improper execution or its failure to execute a payment order it has accepted to the extent provided by the law governing the [account relationship] [relationship between the beneficiary and the bank], and

(b) to its sender and to the originator for any losses caused by the bank's failure to place the funds

at the disposal of the beneficiary in accordance with the terms of a pay date or execution date stated in the order, as provided in article 9.

(5) If a bank is liable under this article to the originator or to its sender, it is obliged to compensate for

(a) loss of interest,

(b) *Deleted*

(c) expenses incurred for a new payment order [and for reasonable costs of legal representation],*

[(d) any other loss that may have occurred as a result, if the improper [or late] execution or failure to execute resulted from an act or omission of the bank done with the intent to cause such improper [or late] execution or failure to execute, or recklessly and with knowledge that such improper [or late] execution or failure to execute would probably result.]

(6) If a receiving bank fails to notify the sender of a misdirected payment order as provided in article 6(3) or 8(2), and the credit transfer is delayed, the receiving bank shall be liable:

(a) if there are funds available, for interest on the funds that are available for the time they are available to the receiving bank, or

(b) if there are no funds available, for interest on the amount of the payment order for an appropriate period of time, not to exceed 30 days.

(7) Banks may vary the provisions of this article by agreement to the extent that it increases or reduces the liability of the receiving bank to another bank and to the extent that the act or omission would not be described by paragraph (5)(d). A bank may agree to increase its liability to an originator that is not a bank but may not reduce its liability to such an originator.

[(8) The remedies provided in this article do not depend upon the existence of a pre-existing relationship between the parties, whether contractual or otherwise. These remedies shall be exclusive and no other remedy arising out of other doctrines of law shall be available.]

Prior discussion

A/CN.9/297, paras. 55 to 63 and 70 to 72
A/CN.9/317, paras. 137 to 150
A/CN.9/328, paras. 66 to 74 and 117 to 144
A/CN.9/329, paras. 187 and 188
A/CN.9/341, paras. 105 to 131

Errors in A/CN.9/341, annex

Paragraph (4) uses the term "pay date" instead of "payment date", as adopted at the twenty-first session.

The text of paragraph (6) refers to articles 6(2) and 8(1) rather than to articles 6(3) and 8(2) as it should.

*Consideration may be given to allowing recovery of reasonable costs of legal representation even if they are not recoverable under the law of civil procedure.

Comments

1. The current text of article 12 is essentially the text as prepared by the Secretariat for the eighteenth session in A/CN.9/WG.IV/WP.39 on the basis of the discussion at the seventeenth session (A/CN.9/317). Certain amendments introduced at the nineteenth session are referred to below at the appropriate places. At the twentieth session a small group consisting of four delegations was asked to consider the liability provisions in general and to attempt to formulate an agreed position that might be considered by the Working Group, but they were unable to reach such an agreed position. Instead they identified four major issues and each of the delegations submitted their separate views for the consideration of the Working Group (A/CN.9/329, paras. 187 and 188). The Working Group did not have the opportunity to consider the matter further at the twentieth session.

2. At the twenty-first session the Working Group had before it a complete redraft of the article that had been proposed by the delegation of the United Kingdom in a communication to the Secretariat (A/CN.9/WG.IV/WP.46, comment 28 to article 12). However, "the Working Group decided that it would be a more appropriate procedure to discuss the original text of article 12, including paragraph (2), and to use the suggested redraft as a source of ideas for improving the text" (A/CN.9/341, para. 106). The discussion at the twenty-first session and the changes to the text that were adopted are indicated below.

Paragraph (1)

3. Paragraph (1) provided that a receiving bank was liable for its failure to fulfil its own obligations under article 5. Since there was a reference to article 5, the receiving bank contemplated was not the beneficiary's bank. The liability of the beneficiary's bank is considered in paragraph (4). At its nineteenth session the Working Group decided to retain the principle of paragraph (1), but to place it in square brackets until it had completed its consideration of the entire article on liability and damages in the expectation that it might be substantially redrafted (A/CN.9/328, para. 131). The Working Group deleted the paragraph at the twenty-first session "since the same matter was covered by paragraph (2)" (A/CN.9/341, para. 104).

Paragraph (2)

4. The general system of liability in paragraph (2) is that the originator can hold the originator's bank liable for the proper performance of the credit transfer. That means that the bank would be responsible to the originator for loss wherever the loss occurred. The types and extent of the losses for which the originator's bank would be liable would be those set forth in paragraph (5). In order to avoid liability the originator's bank would have to show that one of the exempting conditions in article 13 was relevant. If the loss for which the originator's bank is liable to the originator was caused by events that occurred at a subsequent bank in the credit transfer chain, the originator's bank could recover the loss from its receiving bank and each bank in turn could recover from its receiving bank

until, under paragraph (3), a bank could show that the payment order received by the beneficiary's bank was consistent with the payment order received by the bank in question.

5. This system of liability is based on the idea that the originator's bank provides a service to the originator that depends on it having established correspondent relations with other banks. It is a system of liability that is well known in other similar types of economic activity, such as the international transport of goods, where it is common for the carriage to be effected by several different carriers. In some, though not all, conventions on international carriage of goods the claim might be made either against the original contracting carrier or against the carrier where the damage occurred. The procedure envisaged by paragraph (2), similar to the procedure used in those conventions, would ease the procedural problems for the originator since he would not have to claim against a bank in a foreign country with which he had no business relationship. However, it would allow the originator's bank to have recourse against its receiving bank, a bank with which it normally had a continuing business relationship (A/CN.9/341, para. 111).

6. Against this system of liability is the concept that no one should be responsible for the actions of third parties. The originator's bank is not always in a position to know, much less to control, the route that an international credit transfer will take on its way to the beneficiary's bank. When the originator requests his bank to transfer funds to a foreign country, he should know that it was likely that independent intermediary banks might have to be used (A/CN.9/341, para. 108).

7. At the twenty-first session there were contradictory statements as to the standard of care for which the originator's bank would be held liable when the loss occurred because of the acts of an intermediary bank in a foreign country. Under one view the originator's bank would be responsible if the intermediary bank did not act in accord with the performance standards of the Model Law. The example given was that the intermediary bank did not execute the payment order on the day it was received because the standard in that country was next day execution. Under another view, under article 15(1) the actions of the receiving bank, and therefore the standard of care of the originator's bank, would be measured by the rules in force in the State of the receiving bank, i.e., of the intermediary bank (A/CN.9/341, paras. 109 and 110). See comment 10 to article 15.

8. It was decided at the seventeenth session of the Working Group that the originator should also be able to hold an intermediary bank directly liable for the losses suffered, since there may be occasions when recovery from the originator's bank may not be possible (A/CN.9/317, para. 139).

9. This system of liability was discussed at length at the nineteenth session without a final decision being reached as to whether it should be retained, abandoned or modified (A/CN.9/328, paras. 66 to 74 and 144). At the twentieth session the four delegations requested to reach an agreed

position in respect of article 12 were in general in agreement that the responsibility for loss should be that of the bank where the events occurred that caused the loss (A/CN.9/329, para. 188, question 4). At the twenty-first session the Working Group noted that the differences between the opposing views had not been reconciled and it decided, therefore, to retain the paragraph. It was noted that retention of paragraph (2) did not imply any judgment on the other paragraphs of article 12, and particularly on paragraph (5), although it was also recognized that there was a relationship between the type and extent of damages that could be claimed and the appropriate rules for determining which bank or banks should be responsible to the originator for those damages (A/CN.9/341, paras. 105 and 114).

10. Other decisions that have been made by the Working Group in respect of liability and damages may have a bearing on the significance of the provision. At the nineteenth session the Working Group decided that it would consider providing in the Model Law that, when there was a delay in a credit transfer, the beneficiary would have a direct right to recover interest resulting from the delay against the bank that had caused the delay (A/CN.9/328, paras. 131 and 132). At the twenty-first session it was noted that no text had been adopted, but the Working Group proceeded on the assumption that payment of the interest to the beneficiary would be the normal practice (A/CN.9/341, paras. 118 and 119; see also comments 25 to 33). At the twenty-first session paragraph (5)(b), providing that damages might include exchange losses, was deleted and it was decided that any possible recovery for such losses was to be considered in regard to indirect (consequential) damages (A/CN.9/341, para. 124; see comments 38 to 42). At the seventeenth session the degree to which indirect (consequential) damages would be recoverable was limited to situations in which the loss was caused by wilful or reckless action, while at the twenty-first session it was decided that only the bank at which those actions had occurred could be held liable (A/CN.9/317, paras. 115 to 117; A/CN.9/328, paras. 140 to 143; A/CN.9/341, paras. 114 and 126). As a result the only losses that would be subject to the procedures envisioned in paragraph (2) would be interest and the expenses for a new payment order and reasonable costs of legal representation under paragraph (5)(c).

11. It has also been decided that when a credit transfer is not carried out successfully, the originator has a right to a return of the principal sum transferred without regard to the reasons for the failure (article 11(b)). Although article 11(b) could be considered to implement the policy of paragraph (2), it is not considered to be a liability provision (see comment 8 to article 11).

12. At the twenty-first session the Working Group requested the Secretariat to propose to the Working Group a revision of the paragraph, and particularly of the second sentence (A/CN.9/341, para. 115). The Secretariat proposes that the paragraph be revised as follows:

"A receiving bank that is not the beneficiary's bank that accepts a payment order is liable to its sender and to the originator for the losses as set out in paragraph (5)

of this article caused by a delay in the completion of the credit transfer, a failure to complete the credit transfer or a failure to complete it as instructed in the originator's payment order. A receiving bank is liable under subparagraph (5)(d) only to the extent that its actions caused the loss."

13. The opening words of the first sentence of this proposed redraft use the same words that are used in articles 5 and 6. Reference is made to a delay in the completion of the credit transfer, rather than completion of the transfer within the time required by article 9, since the text of article 9 as it has evolved provides for the time within which actions are to be taken in regard to a payment order that has been received but not for the time within which a credit transfer is to be completed. Although a failure to complete a credit transfer as instructed in the originator's payment order most often will lead to a delayed completion, it seems appropriate to include it as a separate item for which the bank is liable. The original second sentence has been deleted, rather than redrafted, since it seems to be currently unnecessary. The new second sentence is intended to implement the decision of the Working Group that only the bank where the error occurred should be liable for the losses under subparagraph (5)(d).

Paragraph (3)

14. Paragraph (3) places a limit on the effect of paragraph (2) when the credit transfer is completed in a manner inconsistent with the originator's payment order. No bank that is subsequent to the error or fraud that caused the inconsistency has any liability for the fact that the credit transfer was carried out improperly. However, such a bank would have obligations under article 11 to assist in correcting the situation. At the twenty-first session it was noted that the provision was technical but that there were matters of drafting and of substance that were contained in the redraft proposed in A/CN.9/WG.IV/WP.46, comment 28 to article 12 to which the Working Group would have to return at a later time. The relevant provision was as follows:

"A receiving bank is not liable under paragraph (2) if the payment order received by each subsequent receiving bank was consistent with the payment order received by it and neither it nor any subsequent receiving bank failed to execute the payment order it received within the time required by article 9 or to comply with any notification obligation mentioned in paragraph (6) [of the proposal]. A receiving bank that does not accept a payment order is liable under paragraph (2) only in respect of its failure to notify rejection in accordance with article 5(3)."

Paragraph (4)

15. The beneficiary's bank might cause loss to the beneficiary by such actions as failing to fulfil its obligations under article 8(4), by failing to accept a payment order it is obligated by contract with the beneficiary to accept or by accepting a payment order the beneficiary has instructed it not to accept.

16. It is a matter of judgment whether the Model Law should contain provisions covering such losses. On the one hand the losses would arise out of the failure in respect of the credit transfer. On the other hand it may be thought that it is not necessary to establish rules on the liability of the beneficiary's bank to the beneficiary, especially when those rules might differ from the domestic rules governing liability for an otherwise identical failure by the bank. Paragraph (4)(a) takes a middle position by referring to the existence of such liability but leaves the substance of the rules governing the liability to the law that governs the account relationship. At the seventeenth session the Working Group decided to defer any decision whether to retain or to delete the subparagraph until it had a more complete view of the entire text (A/CN.9/317, para. 150). At the twentieth session the Working Group considered a similar problem in connection with article 8 (see, article 8, comments 1 to 4).

17. At the twenty-first session the Working Group expressed a preference for the first of the two alternative formulations in square brackets, i.e., "account relationship" (A/CN.9/341, para. 117). The Working Group also decided that subparagraph (a) should include a reference to the failure of the beneficiary's bank to perform one of the obligations under article 8. In the proposal of the delegation of the United Kingdom that had been communicated to the Secretariat prior to the twentieth session, paragraph (6C) included the current text of subparagraph (4)(a) and added "or, if the beneficiary does not maintain an account with the bank, for its failure to notify him in accordance with article 8(6) that it is holding funds for his benefit" (A/CN.9/WG.IV/WP.46, para. 28). However, that does not appear to have been the intention of the Working Group. Although the report is not clear on the point, it appears that the reference to article 8 was intended to replace the words "for its improper execution or its failure to execute a payment order it has accepted". The *chapeau* and subparagraph (a) might, therefore, be drafted as follows:

"The beneficiary's bank is liable

(a) to the beneficiary for its failure to perform one of its obligations under article 8 to the extent provided by the law governing the account relationship, and"

18. While that formulation has the advantage of referring to the obligations set forth in the Model Law itself, it poses a certain difficulty in that no State would have rules that would provide liability for failure to perform an obligation under article 8. Nor would it be convenient to say

"The beneficiary's bank is liable

(a) to the beneficiary for its failure to perform one of the types of obligations set forth under article 8 to the extent provided by the law governing the account relationship, and"

19. If the reference to article 8 was not intended to replace the existing words, the provision might read as follows:

"The beneficiary's bank is liable

(a) to the extent provided by the law governing the account relationship, to the beneficiary for its improper execution or its failure to execute a payment order it has accepted as set forth in article 8, and"

20. The beneficiary's bank might cause loss to the sender or to the originator by failing to give one of the notices required by article 8. For the treatment of such losses, see paragraph (6) and comments 43 and 44. Failure to give a notice of rejection required by article 7(2) would not cause loss to the sender or to the originator since it would lead to acceptance of the payment order by the beneficiary's bank.

21. In addition, as indicated in paragraph (4)(b), the beneficiary's bank might cause loss to the sender or to the originator by failing to place funds at the disposal of the beneficiary in accordance with an execution or payment date. (The text continues to say "pay date" by mistake.) Compare article 8, comment 23.

22. In any redrafting of article 12, consideration might be given to reversing the order of subparagraphs (a) and (b), or to placing them in separate paragraphs.

Paragraph (5)

23. In essence, paragraph (5) applies to losses caused by late or non-completion of a credit transfer. In this sense, timely completion of a transfer for less than the full amount may be considered to be a late transfer for the difference between the proper amount and the amount transferred in fact.

24. Losses arising out of unauthorized payment orders are allocated by article 4(2) and (3). Liability for losses arising out of failure to give the notice required by articles 6(3) and 8(2) is set out in paragraph (6). The obligation of each receiving bank to refund to its sender any funds received from the sender where the transfer was not successfully completed is set forth in article 11(b).

Interest, subparagraph (a)

25. Interest losses may be suffered in several different ways as a result of a credit transfer that does not work as intended. If a receiving bank receives funds from its sender but delays execution of the payment order, the sender (who may be either the originator or a sending bank) may be said to have suffered a loss of interest because it has been deprived of funds earlier than was necessary for the bank to execute the payment order. If the receiving bank receives funds late from its sender but executes the order without waiting for the funds, the receiving bank suffers a loss of interest but no subsequent party, including the beneficiary, suffers any loss. If the result of a delay or error of any kind at a receiving bank is that the entire credit transfer is delayed, the beneficiary could be said to have suffered the loss of interest.

26. If the beneficiary could recover loss of interest from the originator because of late payment of the underlying obligation, the originator might claim for the interest it

had paid to the beneficiary from the bank where the delay occurred or from the originator's bank. In many cases the amount of interest the beneficiary could claim from the originator because of late payment of the underlying obligation would be more than the amount of interest due from the bank because of delayed performance of the credit transfer. At the twenty-first session, when it was suggested that the bank that had caused the delay should have to pay to the beneficiary or to the originator (if the originator had reimbursed the beneficiary) an additional amount equal to the interest due as a result of the late payment of the underlying obligation, less the amount already paid for the delay in the credit transfer, it was stated that such an additional amount was in the nature of indirect (consequential) damages and should be treated as such under the Model Law (A/CN.9/341, para. 120; see comment 41).

27. The Working Group considered the problem of interest extensively at the nineteenth and twenty-first sessions (A/CN.9/328, paras. 122 to 131; A/CN.9/341, paras. 118 to 123). It agreed that, in any case where the beneficiary had been credited later than it should have been because of a delay in the transfer, the receiving bank causing the delay should not benefit from the use of the funds during the period of the delay (A/CN.9/328, para. 122). It noted that it was current banking practice in many important banking centres for a bank at which a transfer was delayed to add an appropriate amount of interest to the amount being transferred. As a result the bank that received the transfer late would automatically receive the interest. This was said to be efficient and expeditious, not requiring any inquiry into the facts of the underlying transaction but giving a remedy that would normally be approximately equal to the loss suffered, and a practice that the legal system should recognize (A/CN.9/328, para. 126).

28. At the conclusion of the discussion at the nineteenth session the Working Group decided that it would be useful to consider providing in the Model Law that the beneficiary would have a direct right to recover interest resulting from the delay against the bank that caused the delay. Since the proposal raised a number of questions that would require consultation, the Working Group requested the Secretariat to prepare a draft of a provision for its consideration at its twentieth session (A/CN.9/328, para. 131). A provision was suggested in the working paper submitted by the Secretariat to the twentieth session, A/CN.9/WG.IV/WP.44, article 12, comment 17, but it was not considered at that session.

29. At the twenty-first session it was stated that where the credit transfer was not completed and the originator had the right to get his funds back under article 11(b), the originator should also be entitled to receive the interest (A/CN.9/341, para. 118).

30. It was also noted that the typical way in which banks compensated one another for interest due was to adjust the date of the credit to the account so that it showed "as of" the date on which the credit should have been entered (A/CN.9/341, para. 119). By changing the date of the credit, appropriate interest would be given automatically

to the bank receiving the credit. It was stated that, in practice, delay in executing a payment order was almost always because the payment order had been executed improperly. As soon as the error was brought to the attention of the bank, it would immediately execute the order correctly for the original amount. Interest adjustments would be made later, usually by way of an "as of" adjustment, although that method was less often used where the person receiving the adjustment did not maintain an account with the bank.

31. Whether the interest due as a result of the delay is credited to the account of the receiving bank as a sum of money or whether the receiving bank effectively receives interest by receiving a credit "as of" an earlier date, there is no guarantee that the receiving bank will pass it on to the next bank in the credit transfer chain, or to the beneficiary. Not only is there the fact that the receiving bank may not perceive any legal obligation to do so, but there are occasions when the receiving bank is the only party to have suffered a loss of interest. It was pointed out at the twenty-first session that in order to overcome that situation there was a proposed rule in the United States that would require the sender (in the case of the return of the amount paid under the equivalent of article 11(b)) or the receiving bank that was the recipient of an "as of" adjustment, but that was not the ultimate party entitled to the interest, to pass on the benefit of the "as of" adjustment to the ultimate originator or beneficiary in the form of interest (A/CN.9/341, para. 119; proposed Regulation J, sec. 210.32(b)(2)). It is suggested in comment 12 to article 11 that a requirement that the receiving bank return the amount of the failed credit transfer "with interest" would automatically cause the interest to be passed back to the originator.

32. An interest rate adjustment between banks would automatically be at the interbank rate in the currency concerned when it was effected by means of an "as of" adjustment of the date on which the account was credited. An "as of" adjustment of the date of crediting a non-bank beneficiary's account would not have the same automatic effect. The effective amount of interest a non-bank beneficiary would receive would depend on whether the account was in debit or in credit during that period of time, since the rate charged on a debit balance is always higher than the rate the beneficiary would receive if the account was in credit.

33. As a result, even though it was suggested that the Model Law should indicate the appropriate rate of interest to be paid, and that the interest should be calculated at the interbank rate in the currency in which the payment order was expressed, the Working Group decided that it would provide only that interest was payable without indicating how that interest should be calculated (A/CN.9/341, paras. 121 and 123).

34. In a communication to the Secretariat prior to the twentieth session the delegation of the United Kingdom suggested several provisions that involved the payment of interest. Those provisions are set out in A/CN.9/WG.IV/WP.46, comment 28 to article 12, paragraphs (6A), (6B)

and (6D). In respect of the right of the beneficiary to recover interest, the proposed paragraph (6B) provided

"If a credit transfer is delayed by the improper execution of a payment order that has been accepted by a receiving bank other than the beneficiary's bank, the bank is liable to compensate the beneficiary for loss of interest. The liability of the bank to the beneficiary is discharged to the extent that it transfers to its receiving bank an amount in addition to that it received from its sender."

35. The end of the second sentence might be amended by adding the words "or makes an appropriate adjustment in the date of the credit." Furthermore, in line with the proposed rule in the United States referred to in comment 31, consideration might be given to adding a new paragraph to the effect that

"If the receiving bank that is the recipient of interest for delay [including by means of an adjustment in the date of the entry of the debit or credit to an account] is not the beneficiary of the transfer, the receiving bank shall pass on the benefit of the interest to its receiving bank."

Exchange losses, subparagraph (b)

36. Subparagraph (5)(b) provided that the bank would be liable for exchange losses arising out of delayed international credit transfers. After discussion at the nineteenth and twentieth sessions of the Working Group (A/CN.9/328, paras. 133 to 136; A/CN.9/329, para. 188), the subparagraph was deleted at the twenty-first session (A/CN.9/341, para. 125).

Expenses of new payment order and legal representation, subparagraph (c)

37. It was suggested at the nineteenth session of the Working Group that the first part of subparagraph (5)(c) was not of great importance because the amounts of money involved were minor, and the receiving bank might well have to bear the expenses of a new payment order as part of its obligation under article 11(a) to help rectify a credit transfer that had not been carried out properly. The second part of the subparagraph was put in brackets and the footnote was added because of the difficulties of formulating a rule that reflected the various means by which the costs of legal representation were distributed in the different legal systems (A/CN.9/328, paras. 137 to 139). At the twenty-first session the Working Group considered that the issues raised in the subparagraph were of minor importance that should be left for discussion at a later stage (A/CN.9/341, para. 125).

Other losses, subparagraph (d)

38. In respect of paragraph (5)(d) the Working Group decided at its seventeenth session that, in exchange for a relatively strict regime of liability, the bank liable would not be responsible for indirect losses unless more stringent requirements were met than for the other elements of loss (A/CN.9/317, paras. 115 to 117). That decision was reaffirmed in another context at the eighteenth session of the

Working Group (A/CN.9/318, paras. 146 to 150). As suggested at the seventeenth session the formula used in the current text was taken from article 8 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules). In order to recover the indirect losses, the claimant would have to prove the intent or the reckless behaviour of the bank.

39. At the nineteenth session retention of the essence of the provision was again reaffirmed (A/CN.9/328, paras. 140 to 143). However, the formulation of the subparagraph was criticized as being imprecise. It was said that the subparagraph was not clear as to the types of losses that were to be covered or that those losses should have been the direct consequence of the failure on the part of the bank. The formula taken from article 8 of the Hamburg Rules for limiting the right to recover was said not to reflect properly the problems of making credit transfers (A/CN.9/328, para. 142). After discussion the Working Group decided to place square brackets around the words "any other loss" and around the words taken from the Hamburg Rules to indicate its intention to redraft the provision.

40. At the twentieth session three of the four delegations that were asked to formulate an agreed position were in favour of retaining the provision in one form or another, while one delegation was in favour of deleting the provision (A/CN.9/329, para. 188, question 3).

41. At the twenty-first session the Working Group decided to limit the application of subparagraph (d) so that only the receiving bank that had committed the error that caused those losses could be held responsible to the originator or to its sender (A/CN.9/341, para. 114 and 126). Following that decision the Working Group considered at length whether the provision should be retained at all (A/CN.9/341, paras. 127 to 131). At the end of the discussion a suggestion was made to delete both paragraph 5(d) and paragraph (8). Under that proposal the Model Law would not provide for consequential damages under any circumstances, but a party would not be precluded from relying on other doctrines of law that might be available in the relevant legal system to claim such damages. A similar suggestion was that paragraph (5)(d) and paragraph (8) might be combined so that banks would be subject to other relevant doctrines of law when they acted in the ways described in the current text of paragraph (5)(d). The Working Group decided that it would need more time to study the implications of the suggestions that had been made. It placed both texts in square brackets so that it could reconsider them at the next session.

42. In a communication to the Secretariat subsequent to the twenty-first session the delegation of the United Kingdom suggested that, if its proposed redraft of paragraph (5)(d) was not accepted (A/CN.9/WG.IV/WP.46, comment 28 to article 12), the proposal to combine paragraph (5)(d) with paragraph (8) might be accomplished by adding to the end of the current text of paragraph (8) the following words:

"save any under which a bank is liable to compensate for loss because the improper or late execution or

failure to execute resulted from an act or omission of that bank done with the intent to cause such loss, or recklessly and with knowledge that such loss might result."

Paragraph (6)

43. In most cases of breach of duty under the Model Law the harm that is suffered is reasonably clear and the remedy of the injured party can be left to the general provisions of paragraph (5). When the Working Group adopted the provision requiring a receiving bank to notify its sender of a misdirected payment order, articles 6(3) and 8(2) in the current draft, it noted that the harm suffered might not always be easy to measure. Nevertheless, it was of the view that there should be a sanction for a bank's failure to notify the sender where that failure to notify delayed the transfer (A/CN.9/318, para. 122). Where the receiving bank was in possession of funds during the period it failed to notify the sender of the misdirection, the obligation to pay interest is in the nature of restitution of what the bank can be assumed to have earned from having been in possession of the funds as well as what the sender can be assumed to have lost. Where the receiving bank was not in possession of funds, the requirement to pay interest for up to 30 days serves only as a measure of the loss the sender can be assumed to have suffered.

44. In a redraft of the entire article suggested by the delegation of the United Kingdom in a communication to the Secretariat subsequent to the twentieth session that was set forth in A/CN.9/WG.IV/WP.46, comment 28 to article 12, the following provisions were relevant to the general problems considered in paragraph (6):

"(6) This paragraph applies to a receiving bank which is liable only in respect of its failure or the failure of a subsequent receiving bank to comply with any of the following notification obligations:

(a) to notify rejection in accordance with article 5(3) or 7(2), where payment has not been received from the sender;

(b) to notify misdirection in accordance with article 6(3) or 8(2);

(c) to notify a lack of sufficient data in accordance with article 6(4) or 8(3);

(d) to notify an inconsistency between the words and figures that describe the amount of money in accordance with article 6(5) or 8(4).

If a bank to which this paragraph applies is liable under this article to the originator or to its sender, it is obliged to compensate only for loss of interest for a maximum of 7 days or the period during which it held the funds, whichever is the longer."

Paragraph (7)

45. Paragraph (7) provides an important rule setting forth the extent to which the provisions of this article can be varied by agreement of the parties. Paragraph (7) would constitute a limitation on the general right of the parties to vary their rights and obligations by contract that is

contained in article 16 as it was adopted by the Working Group at the twenty-first session (A/CN.9/341, para. 52).

Paragraph (8)

46. Paragraph (8), making the liability provisions of this article not dependent on a contractual relationship and making them exclusive, was added at the suggestion of the Working Group at its seventeenth session (A/CN.9/317, para. 119). Without such a provision some legal systems might permit other remedies based on general theories of obligation, thereby destroying the uniformity of law the Model Law seeks to achieve.

47. At the twenty-first session it was suggested that both paragraph (5)(d) and paragraph (8) should be deleted or that they should be combined (A/CN.9/341, para. 130; see comments 41 and 42). At that session the Working Group decided to place both paragraphs in square brackets and to reconsider them at the next session.

Comparison with Article 4A

48. Article 4A-305 provides that a receiving bank is liable for its late or improper execution or failure to execute a payment order. In the case of late completion the bank "is obliged to pay interest to either the originator or the beneficiary . . .". In the case of other types of improper or non-execution, the bank "is liable to the originator for its expenses in the funds transfer and for incidental expenses and interest losses . . . resulting from the improper execution. "If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute." In all cases additional "damages, including consequential damages, are recoverable [only] to the extent provided in an express written agreement of the receiving bank".

Proposed new paragraph

49. In a communication to the Secretariat subsequent to the twenty-first session the delegation of the United Kingdom suggested that an additional difficulty with article 12 that had not so far been addressed by the Working Group was that a bank which is obliged to pay compensation to its sender or to the originator and which is entitled to recover the compensation from its receiving bank but is unable to do so because that bank is insolvent has no right to recover the compensation from a bank further down the chain. If the bank further down the chain has already paid the compensation to the insolvent bank or to an intermediary bank, it should not have to pay again, but if it has not yet paid, there seems to be no reason why it should not pass over the insolvent bank and pay the bank higher up the chain. To deal with that situation, the United Kingdom delegation suggested the following new paragraph, which is based on the structure of its redraft of article 12 in A/CN.9/WG.IV/WP.46, para. 28 to article 12:

"A bank which is entitled to recover compensation from its receiving bank under this article but is unable to do so owing to the latter's insolvency shall, subject

to paragraph (6E), be entitled to recover the compensation from any subsequent bank to the extent that that bank has not already paid compensation to its sender under this article, and that subsequent bank's liability to pay compensation to its sender shall be discharged to the extent that it pays such compensation to the first mentioned bank."

Article 13. *Exemptions*

A receiving bank and any bank to which the receiving bank is directly or indirectly liable under article 12 is exempt from liability for a failure to perform any of its obligations if the bank proves that the failure was due to the order of a court or to interruption of communication facilities or equipment failure, suspension of payments by another bank, war, emergency conditions or other circumstances that the bank could not reasonably be expected to have taken into account at the time of the credit transfer or if the bank proves that it could not reasonably have avoided the event or overcome it or its consequences.

Prior discussion

A/CN.9/297, para. 60
A/CN.9/317, paras. 151 to 156

Comments

1. Since the liability of a receiving bank for the interest loss and expenses incurred for a new payment order would arise out of the simple fact of failure of the transfer, article 13 provides the receiving bank with its sole basis of defence in such cases.

2. Article 13 does not apply to the obligation of a receiving bank under article 11(b) to refund to its sender any funds received from the sender when a payment order consistent with the contents of the payment order issued by the originator was not issued or accepted by the beneficiary's bank. It also does not seem to apply to the bank's obligation to pay "any other loss" under article 12(5)(d), since that provision has its own strict limitation on liability. (See article 12, comments 38 to 42.) Furthermore, it can be questioned whether the application of article 13 to loss of interest would be consistent with the decision of the Working Group at its nineteenth session that a bank that caused a delay in a credit transfer should not be allowed to earn interest on the funds that were in its possession because of the delay (A/CN.9/328, para. 122) or with the decision at the seventeenth session that the receiving bank that fails to notify its sender of a misdirected payment order should be liable for interest. (For the current situation in regard to the duty of a bank to pay interest because of a failure to fulfil one of its obligations, see article 12, comments 25 to 35 in regard to paragraph (5)(a), and comments 43 and 44 in regard to paragraph (6).)

3. Under article 13 the bank must prove the exempting condition. Although there is a list of specific circumstances that might exempt the bank from liability, the reference to "other circumstances" indicates that the list is

not exhaustive. The current draft of article 13 has not been discussed by the Working Group.

4. In a communication to the Secretariat subsequent to the twentieth session the delegation of the United Kingdom has suggested a redraft as follows:

"A receiving bank and any bank to which the receiving bank is liable under article 12 is exempt from liability for a failure to perform any of its obligations under that article if the bank proves that the failure was due to circumstances which were beyond the bank's control and which it could neither avoid nor overcome."

5. *Comparison with Article 4A.* There is no equivalent provision in Article 4A.

CHAPTER IV. CIVIL CONSEQUENCES OF CREDIT TRANSFER

Article 14. *Payment and discharge of monetary obligations; obligation of bank to account holder*

(1) *Deleted*

(2) If the transfer was for the purpose of discharging an obligation of the originator to the beneficiary that can be discharged by credit transfer to the account indicated by the originator, the obligation is discharged when the beneficiary's bank accepts the payment order and to the extent that it would be discharged by payment of the same amount in cash.

(2 *bis*) A credit transfer is completed when the beneficiary's bank accepts the payment order. When the credit transfer is completed, the beneficiary's bank becomes indebted to the beneficiary to the extent of the payment order accepted by it.

(3) If one or more intermediary banks have deducted charges from the amount of the credit transfer, the obligation is discharged by the amount of those charges in addition to the amount of the payment order as received by the beneficiary's bank. Unless otherwise agreed, the debtor is bound to compensate the creditor for the amount of those charges.

(4) *Deleted*

Prior discussion

A/CN.9/317, paras. 157 to 164
A/CN.9/328, paras. 37 to 43
A/CN.9/329, paras. 189 to 192
A/CN.9/341, paras. 11 to 23

Comments

Paragraph (1)

1. Paragraph (1) provided that monetary obligations could be discharged by interbank credit transfers leading to credit to an account. The paragraph was deleted at the

twenty-first session (A/CN.9/341, para. 12). The reasons given were that, while many legal systems already recognized credit transfers as an acceptable method of making payment, it was a matter of the policy of each State to decide whether a monetary obligation could be discharged by a credit transfer and that it might be contrary to the monetary policy of some States to consider credit in an account in a bank as having the same legal significance as money issued by a central bank.

Paragraph (2)

2. Prior to the twenty-first session paragraph (2) provided that the obligation of the debtor was discharged when the beneficiary's bank accepted the payment order. The beneficiary's bank became indebted to the beneficiary at the same time. The drafting history of that prior provision is set forth in A/CN.9/WG.IV/WP.46, comments 5 to 9 to article 14. The current text was adopted at the twenty-first session (A/CN.9/341, paras. 13 to 17).

3. Although there was a widespread feeling in the Working Group that the Model Law should neither provide that a debtor had a right to discharge an obligation by transferring funds to the credit of the creditor in his bank account nor provide that if such a transfer was made the obligation would be discharged to the extent of the payment order received, there was a recognition that it would be useful to provide a rule that governed certain aspects of the discharge when the parties had agreed that the obligation could be discharged by a credit transfer. In particular, it was thought to be useful for the Model Law to indicate the time when such a discharge took place.

4. Paragraph (2) applies only if the transfer was for the purpose of discharging an obligation of the originator/debtor to the beneficiary/creditor and if that obligation could be discharged by credit transfer to the account indicated by the originator. Although it is unlikely that any State has a general prohibition against credit transfers, and especially international credit transfers, it is possible that certain obligations can be discharged only by payment in cash or by some other specified means. What is more likely is that in a given State an obligation is discharged by credit transfer to an account of the beneficiary only if the transfer is done with his consent. It may be that the consent need not be specific, that it could be implied from the very fact of having a particular type of account, from the indication of the bank account numbers on an invoice or from other similar circumstances.

5. If paragraph (2) applies, it provides that the obligation is discharged when the beneficiary bank accepts the payment order. Although not specifically so stated in paragraph (2), the payment order accepted by the beneficiary's bank must have been addressed to the proper account. If the payment order was addressed to the proper account but the beneficiary's bank failed to credit the account or credited the wrong account, the obligation from the originator to the beneficiary is discharged and if the beneficiary suffered loss as a result of the misapplication of the credit, he must look to his bank for reparation under the law applicable to the account relationship.

6. Paragraph (2) provides that the obligation is discharged to the extent that it would be discharged by payment of the same amount in cash. The amount in question is the amount of the payment order accepted by the beneficiary's bank. If the beneficiary's bank charges a fee for receiving and processing the payment order, the fee is at the cost of the beneficiary. However, if the payment order accepted by the beneficiary's bank is for an amount less than the amount in the payment order sent by the originator's bank as a result of fees charged by intermediary banks, the originator is not discharged of his obligation to the beneficiary to the extent of those fees. Compare comment 8.

7. In most cases when less than the full amount of the obligation is paid, the obligation is discharged to the extent of the payment. However, in some cases the obligation is indivisible and payment of less than the full amount does not operate as a discharge of any of the obligation (A/CN.9/328, para. 39). Those are questions that are settled by doctrines outside the law of credit transfers. However, in order to know the effect of a transfer of a sum that is less than the entire obligation, paragraph (2) provides that the obligation is discharged to the extent that it would be discharged by payment of the same amount in cash.

8. *Comparison with Article 4A.* Article 4A-406 has substantially the same rule in respect of time of discharge, subject to the qualification that the acts of acceptance of a payment order by a beneficiary's bank are slightly different in Article 4A-209(b) from what they are in article 7. Article 4A-406(c) provides that the extent of the discharge is the amount of the originator's order "unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges".

Paragraph (2 bis)

9. Although earlier versions of the draft Model Law had implied that the credit transfer was completed when the beneficiary's bank accepted the payment order, a specific rule as to when the credit transfer was completed was first introduced into the draft Model Law at the twentieth session when it was placed in the definition of "credit transfer" in article 2(a) (A/CN.9/329, paras. 31 to 33). At the twenty-first session it was moved to article 14 (A/CN.9/341, para. 17). As had previously been the case, the credit transfer is completed when the beneficiary's bank accepts the payment order.

10. Although the general policy of the Model Law is not to enter into the relationship between the beneficiary and the beneficiary's bank, paragraph (2 bis) goes on to say that when the credit transfer is completed, the beneficiary's bank becomes indebted to the beneficiary to the extent of the payment order accepted by it. The provision does not provide when or how the beneficiary's bank must make the funds available to the beneficiary or the extent to which the beneficiary's bank can charge the beneficiary a fee for receiving and processing the transfer. Those are questions to be settled by the law applicable to the account relationship.

11. Paragraphs (2) and (2 *bis*) are complementary in that, if the credit transfer was for the purpose of discharging an obligation, the beneficiary's claim against the originator/debtor is discharged at the same moment and to the same extent that the beneficiary's claim arises against the beneficiary's bank.

12. *Comparison with Article 4A.* Article 4A-104(a) provides that "A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order." The acts of acceptance of a payment order by the beneficiary's bank are somewhat different in article 4A-209(b) from what they are in article 8.

Review of the concept of acceptance

13. At the twenty-first session the Working Group noted that by its adoption of paragraphs (2) and (2 *bis*) in their current form, it had decided that the point of time when the credit transfer was completed with the legal consequences that followed was when the beneficiary's bank accepted the payment order addressed to it. Consequently, the Working Group did not exclude the possibility that it would reconsider the issue of acceptance of a payment order as it was set forth in articles 5 and 7 (A/CN.9/341, para. 17).

14. In a communication to the Secretariat prior to the twentieth session the delegation of France proposed a different formulation for what is presently the first sentence of paragraph (2 *bis*). The French proposal is as follows:

"Unless otherwise agreed by the sender and the beneficiary, a transfer is completed when the beneficiary's bank places the funds at the beneficiary's disposal or notifies him that it is holding the funds for his benefit, in accordance with article 8(1) or (6)."

If the French proposal was accepted, consequential changes would have to be made to paragraph (2) and to the second sentence of paragraph (2 *bis*).

Paragraph (3)

15. Paragraph (3) is concerned with a problem that is difficult, even though it does not involve a significant amount of money, when credit transfers pass through several banks. It could be expected that the originator would be responsible for all charges up to the beneficiary's bank. So long as those charges are passed back to the originator, there are no difficulties. When this is not easily done, a bank may deduct its charges from the amount of the funds transferred. Since it may be impossible for an originator to know whether such charges will be deducted or how much they may be, especially in an international credit transfer, it cannot provide for that eventuality. In order to overcome that problem, paragraph (3) as it is set out above provides that the obligation is discharged by the amount of the charges that have been deducted as well as by the amount received by the beneficiary's bank. Therefore, the originator would not be in breach of contract for late or inadequate payment. Nevertheless, unless the beneficiary agrees to pay the charges,

which often occurs, the originator would be obligated to reimburse the beneficiary for them.

16. At the twenty-first session the Working Group decided that paragraph (3) should be redrafted to state that the credit transfer was complete and the originator's bank had fulfilled its duty to the originator even though the amount of the payment order accepted by the beneficiary's bank was less than the amount of the payment order issued by the originator because of the fees that had been deducted by various banks in the transfer chain. It also decided that paragraph (3) should provide that completion of the transfer would not prejudice any right the beneficiary might have under other applicable rules of law to recover the balance of the original amount of the transfer from the originator, but that the paragraph should not purport to determine whether the originator or the beneficiary was ultimately responsible to pay the fees for the transfer (A/CN.9/341, para. 20).

17. In implementation of that decision the Secretariat would suggest that paragraphs (2 *bis*) and (3) should be redrafted as follows:

"(2 *bis*) A credit transfer is completed when the beneficiary's bank accepts a payment order consistent with the payment order issued by the originator. A payment order issued to the beneficiary's bank is consistent with the payment order issued by the originator even though the amount of the transfer has been reduced by fees charged by one or more intermediary banks. When the credit transfer is completed, the beneficiary's bank becomes indebted to the beneficiary to the extent of the payment order accepted by it.

(3) The provisions of paragraph (2 *bis*) do not prejudice any right the beneficiary may have to recover from the originator the amount of the fees deducted from the amount of the transfer."

18. A provision that the originator's bank has fulfilled its obligations to the originator when the credit transfer is completed has not been included, since it would seem to be a natural consequence of completion of the transfer.

19. In a communication to the Secretariat subsequent to the twenty-first session the delegation of the United Kingdom suggested that the decision of the Working Group might be implemented by the following redraft of paragraph (3):

"A credit transfer shall be considered complete notwithstanding that the amount of the payment order accepted by the beneficiary's bank is less than the amount of the originator's payment order because any receiving bank has deducted charges. The completion of the credit transfer shall not prejudice any right of the beneficiary under the applicable law to recover the amount of those charges from the originator."

20. *Comparison with Article 4A.* Article 4A-302(d) contains a prohibition on the collection of charges "by issuing a payment order in an amount equal to the amount of the sender's order less the amount of the charges . . ." unless instructed by the sender to do so.

Article 4A-406(c) provides that if charges of one or more receiving bank have been deducted (perhaps by a foreign bank) "payment to the beneficiary is deemed to be in the amount of the originator's order unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges".

Paragraph (4)

21. Paragraph (4) provided that the account of a sender, including but not limited to the originator, was to be considered debited, and the amount owed by the bank to the sender reduced or the amount owed by the sender to the bank increased when the receiving bank accepted the payment order. Paragraph (4) would have had its most important application in determining whether credit was still available in the account holder's account if legal process had been instituted against the account or insolvency proceedings had been instituted against the sender. At the twenty-first session the Working Group deleted the paragraph (A/CN.9/341, para. 22).

Order of paragraphs

22. With the new content of paragraph (3) the Working Group might consider that the logical order for article 15 would be paragraphs (2 *bis*), (3), (2), to be renumbered as (1), (2) and (3). Alternatively, current paragraph (2) might become a separate article.

New title of article and of chapter

23. At the twenty-first session the Working Group noted that the title of the article should be changed to reflect the current content of the article (A/CN.9/341, para. 23). If article 14 is divided into two articles, as suggested above, article 14 might be entitled "Completion of credit transfer" and article 14 *bis* might be entitled "Time and extent of discharge of obligation". If the article 14 is not divided, the title might be "Completion of credit transfer and discharge of obligation".

24. Whether or not current article 14 is divided, the title of the chapter might be changed to "Completion of credit transfer and discharge of obligation".

CHAPTER V. CONFLICT OF LAWS

Article 15. *Conflict of laws*

[(1) Persons who anticipate that they will send and receive payment orders may agree that the law of the State of the sender, of the receiver or of the State in whose currency the payment orders are denominated will govern their mutual rights and obligations arising out of the payment orders. In the absence of agreement, the law of the State of the receiving bank will govern the rights and obligations arising out of the payment order.

(2) In the absence of agreement to the contrary, the law of the State where an obligation is to be discharged governs the mutual rights and obligations of an

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

Prior discussion

A/CN.9/297, paras. 34 to 36

A/CN.9/317, para. 165

A/CN.9/WG.IV/WP.42, paras. 69 to 80

A/CN.9/341, paras. 24 to 49

Comments

1. The Working Group at its seventeenth session requested the Secretariat to prepare a draft provision on conflict of laws (A/CN.9/317, para. 165). The draft provision set out above was prepared for the eighteenth session of the Working Group. The problem of conflict of laws was considered in more detail in the report of the Secretary-General to the nineteenth session of the Working Group, A/CN.9/WG.IV/WP.42, paras. 69 to 80. That report considered the issues especially in light of the decisions of the Working Group at its eighteenth session that the text under preparation should be in the form of a model law for adoption by national legislative bodies and that it should be restricted to international credit transfers. At the twenty-first session the Working Group made a number of policy decisions that have not as yet been incorporated into the text. It also decided to place the entire article in square brackets pending a final review at a later session (A/CN.9/341, para. 49).

Inclusion of conflict of laws provisions in the Model Law

2. At the twenty-first session there was a long discussion as to whether the Model Law should retain any provision on conflict of laws (A/CN.9/341, paras. 33 to 37). One objection to retaining any provision was that a certain number of States were already parties to bilateral or multi-lateral conventions on conflict of laws, and in particular to the Rome Convention on the Law applicable to Contractual Obligations between the member States of the European Communities, and that it would be difficult for those States to adopt any conflict of laws provisions that might be in the Model Law. A second objection was that no single conflicts rule would be appropriate for both high-speed electronic transfers and paper-based transfers. A third objection was that, considering the complexity of the issues involved, the current text did not have the degree of refinement that would make it acceptable to most States.

3. The Working Group decided to retain a provision on conflict of laws, primarily on the grounds that it could not be anticipated that the law governing international credit transfers would be uniform in the entire world by virtue of all States having adopted the Model Law in its entirety.

Therefore, it was necessary for parties in States that had adopted the Model Law to know what law would govern the various relationships in an international credit transfer. Although it was possible that some States that would adopt the Model Law might have difficulties in adopting the conflict of laws provisions because of bilateral or multilateral conventions to which they might be a party, that was no more of a reason not to include such provisions in the Model Law than the existence of national provisions on the substance of the law governing credit transfers would be a reason not to include equivalent substantive provisions in the Model Law.

Paragraph (1)

4. One of the primary difficulties that the Working Group faced in preparing a legal regime for international credit transfers is the dichotomy between the point of view of the originator and beneficiary of the credit transfer (particularly when neither of those parties is a bank) and that of the implementing banks. From the point of view of the originator and the beneficiary, the transfer is a single operation in which their rights and obligations in respect of the transfer itself should be governed by a single law. From the viewpoint of the banks an international credit transfer is effectuated by a series of individual payment orders giving rise to rights and obligations of the sender and the receiving bank. From that point of view, each bilateral relationship in the credit transfer chain is a separate banking transaction. Being a separate banking transaction, the law applicable to that relationship might be different from the law applicable to the other bilateral relationships that taken together constitute the credit transfer chain. That, however, is unsatisfactory in that the smooth implementation of international credit transfers requires that the rights and obligations of all parties are consistent with one another.

5. The following proposal was made at the twenty-first session to overcome those difficulties:

"A funds transfer system may select the law of a particular State to govern the rights and obligations of all parties to a high-speed electronic transfer. In the event of any inconsistency between any provision of the law of the State selected by the funds transfer system and any provision of this Model Law, the provision of the law of the State selected by the funds transfer system shall prevail."

6. In support of the proposal it was stated that it was particularly important that one set of rules govern the rights and obligations of all the parties when the transfer was a high-speed transfer (A/CN.9/341, paras. 24 to 32). It was said that, unless there was a means for the parties to elect the application of a single law as was here proposed, the general rules of choice of law reflected in article 15(1) would lead to the result that the law of different States would apply to the different segments of the credit transfer and that there would be no single law that would govern the entire credit transfer. It was pointed out that the technique suggested had already been implemented by CHIPS in its new rule 3 and the law of New York had been chosen to govern the entire transfer if any

part of it passed through CHIPS. (The CHIPS rule is set out in A/CN.9/WG.IV/WP.47.)

7. The proposal was rejected by the Working Group on the grounds that, even if it might be reasonable when restricted to the relationships between the banks, the proposal was excessive when it attempted to impose a law upon non-bank originators and beneficiaries that was different from that which would otherwise be applicable to their rights and obligations and that they had not themselves chosen. The proposal would have given the funds transfer system, which in fact meant the banks, unfettered freedom to choose any law. The concern was expressed that the funds transfer system might choose a law that was particularly favourable to the banks and unfavourable to the non-bank originators and beneficiaries.

8. At the twenty-first session the Working Group tried to find other rules that would also have led to the application of a single law to the entire transaction. One suggestion was that the substantive provisions of the Model Law applicable to the relations between the originator and the originator's bank should be governed by the law of the originator's bank but that the rest of the credit transfer should be governed by the law of the beneficiary's bank (A/CN.9/341, para. 38). Finally, it was decided that the only way to ensure that the Model Law might become applicable to the entire credit transfer was by its adoption by the several States concerned (A/CN.9/341, para. 39).

9. While the Working Group had not been willing to allow any group of banks to decide that the Model Law or any other law would apply to parties to the transfer that were not parties to the choice-of-law agreement, the Working Group was in favour of permitting the parties to choose any law they wished to govern their relationship (A/CN.9/341, paras. 44 and 45).

10. The Working Group decided that in the absence of a choice of law by the parties, the law of the receiving bank should apply to that segment of the transfer (A/CN.9/341, paras. 46 and 47). The only exception was that it should be made clear that the Model Law did not purport to determine what law would determine the authority of the actual sender to bind the purported sender under article 4(1).

Paragraph (2)

11. Although there was widespread sentiment at the twenty-first session for deleting paragraph (2) entirely, it was provisionally retained since a rule had been retained in article 14(2) as to the time when an obligation would be discharged by a credit transfer (A/CN.9/341, para. 48).

Comparison with Article 4A

12. Article 4A-507 is generally consistent with paragraph (1), as the Working Group decided at the twenty-first session to modify it, and with the second sentence of paragraph (2), except that Article 4A would apparently

apply the law of the receiving bank to the question whether an actual sender was authorized to send a payment order. Article 4A-507(c) is a slightly more complicated version of the provision set out in comment 5 that was rejected by the Working Group at the twenty-first session.

Proposed redraft of article 15

13. In a communication to the Secretariat subsequent to the twenty-first session the delegation of the United Kingdom suggested the following redraft of article 15:

"(1) The rights and obligations arising out of a payment order shall be governed by the law chosen by the parties. In the absence of agreement the law of the State of the receiving bank shall apply.

(2) The second sentence of paragraph (1) shall not affect the determination of which law governs the question whether the actual sender of the payment order had the authority to bind the purported sender for the purposes of article 4(1).

(3) Where the rights and obligations referred to in paragraph (1) are embodied in a contract, that paragraph shall not affect the application of any rule of law

(a) for determining which law governs the formal validity of the contract; or

(b) applying the law of another State if it appears from the circumstances as a whole that the contract is more closely connected with that State.

(4) Paragraph (1) shall not apply to the extent that its application would be manifestly incompatible with the public policy of the forum.

(5) The application of the law of any State specified by this article means the application of the rules of law in force in that State other than its rules of private international law.

(6) For the purposes of this article

(a) where a State comprises several territorial units having different rules of law each territorial unit shall be considered to be a separate State, and

(b) branches of a bank in different States shall be considered to be separate banks."

14. The delegation of the United Kingdom noted that the purpose of paragraph (3) was to make article 15 compatible with the Rome Convention on the Law Applicable to Contractual Obligations. It also noted that its proposed redraft would delete the current paragraph (2).

Article 16

Except as otherwise provided in this Law, the rights and obligations of a party to a credit transfer may be varied by agreement of the affected party.

Prior discussion

A/CN.9/318, para. 34

A/CN.9/WG.IV/WP.47

A/CN.9/341, paras. 50 to 52

Comments

1. At its eighteenth session the Working Group decided that the extent to which the Model Law would be subject to the agreement of the interested parties would be considered in connection with the individual provisions (A/CN.9/318, para. 34). As a result a number of the individual articles contained a provision permitting or restricting the parties from derogating from the specific provision. A part of a proposal submitted by the United States prior to the twenty-first session, and distributed as A/CN.9/WG.IV/WP.47, contained two paragraphs in respect of the right to vary the provisions of the Model Law. The first paragraph of the proposal was adopted by the Working Group as article 16 (A/CN.9/341, para. 52). The second paragraph, which was not pursued by the United States delegation after a corresponding proposal in respect of article 15 had been rejected (see comment 7 to article 15), provided that rules adopted by a funds transfer system could be effective between the participating banks "even if the rule conflicts with this law and indirectly affects another party to the funds transfer who does not consent to the rule."

2. Under article 16 the agreement of the affected party need not be with the party to the credit transfer who claims under the agreement. For example, an agreement of the originator with the originator's bank that the beneficiary's bank in another State could execute the payment order it received on the basis of the account number only would be binding on the originator as against the beneficiary's bank.

3. When the Working Group adopted article 16 it decided to review each of the substantive articles to determine whether the statements in the individual substantive provisions as to the effect of an agreement should be retained or could be deleted (A/CN.9/341, para. 52). In the current draft mention of the effect of contractual rules is made in articles 2(j), 4(4), 5(2)(b), 6(5), 7(1)(b), 8(4), 10(3), 10(4), 10(5), 12(7), 14(1), 14(3), 15(1) and 15(2). See the comments to those provisions as to the effect of article 16.

4. *Comparison with Article 4A.* Article 4A-501(a) is identical to article 16. Article 4A-501(b) is a longer version of the provision referred to in comment 1 and set forth in A/CN.9/WG.IV/WP.47 that was rejected by the Working Group at the twenty-first session.

Proposed title and location of the article

5. It is suggested that article 16 might be entitled "Variation by agreement". It is suggested that article 16 might be moved to article 3.

II. PROCUREMENT

A. Report of the Working Group on the New International Economic Order on the work of its twelfth session (Vienna, 8-19 October 1990)

(A/CN.9/343) [Original: English]

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*Gaps appearing in the numbering of the second draft of articles 1 to 27 are due to the deletion and consolidation of several articles contained in the first draft pursuant to decisions taken by the Working Group at the eleventh session.

INTRODUCTION

1. At its nineteenth session in 1986, the Commission decided to undertake work in the area of procurement as a matter of priority and entrusted that work to the Working Group on the New International Economic Order.¹ The Working Group commenced its work on this topic at its tenth session, held at Vienna from 17 to 25 October 1988, by considering a study of procurement prepared by the Secretariat.² The Working Group requested the Secretariat to prepare a first draft of a model law on procurement and an accompanying commentary taking into account the discussions and decisions at the session.³

2. A draft of the model law on procurement and an accompanying commentary prepared by the Secretariat (A/CN.9/WG.V/WP.24 and A/CN.9/WG.V/WP.25) were considered by the Working Group at its eleventh session (5 to 16 February 1990). The Working Group requested the Secretariat to revise the text of the model law taking into account the discussion and decisions at the session. It was agreed that the revision need not attempt to perfect the structure or drafting of the text. It was also agreed that the commentary would not be revised until after the text of the model law had been settled, and that no revision of the commentary would be prepared for the twelfth session of the Working Group. In addition, the Working Group requested the Secretariat to prepare for the twelfth session draft provisions on the review of acts and decisions of, and procedures followed by, the procuring entity.⁴

3. At its twenty-third session (25 June to 6 July 1990), the Commission expressed appreciation for the work performed by the Working Group so far and requested it to proceed with its work expeditiously.⁵

4. The Working Group, which was composed of all States members of the Commission, held its twelfth session at Vienna from 8 to 19 October 1990. The session was attended by representatives of the following States members of the Working Group: Argentina, Bulgaria, Canada, Chile, China, Czechoslovakia, Egypt, France, Germany, India, Iran (Islamic Republic of), Japan, Kenya, Libyan Arab Jamahiriya, Mexico, Morocco, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America, Yugoslavia.

5. The session was attended by observers from the following States: Finland, Kuwait, Lebanon, Oman, Pakistan, Philippines, Republic of Korea, Romania, Saudi Arabia, Switzerland, Thailand, Turkey.

6. The session was also attended by observers from the following international organizations:

(a) *United Nations organizations*: International Bank for Reconstruction and Development, International Labour Office, International Trade Centre UNCTAD/GATT, United Nations Industrial Development Organization;

(b) *Intergovernmental organizations*: League of Arab States, Office Central des Transports Internationaux Ferroviaires (OTIF);

(c) *International non-governmental organizations*: International Bar Association.

7. The Working Group elected the following officers:

Chairman: Mr. Robert Hunja (Kenya)

Rapporteur: Ms. Jelena Vilus (Yugoslavia).

8. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.V/WP.26);

(b) Procurement: review of acts and decisions of, and procedures followed by, the procuring entity under the Model Law on Procurement (A/CN.9/WG.V/WP.27);

(c) Procurement: second draft of articles 1 to 35 of Model Law on Procurement (A/CN.9/WG.V/WP.28).

9. The Working Group adopted the following agenda:

(a) Election of officers;

(b) Adoption of the agenda;

(c) Procurement;

(d) Other business;

(e) Adoption of the report.

10. With respect to its consideration of item (c), the Working Group decided to turn its attention first to the second draft of articles 1 to 35 of the Model Law on Procurement (A/CN.9/WG.V/WP.28). It was decided to defer consideration of the review of acts and decisions of, and procedures followed by, the procuring entity under the Model Law on Procurement (A/CN.9/WG.V/WP.27) until such time as the review of the second draft of articles 1 to 35 was completed.

DELIBERATIONS AND DECISIONS

I. Discussion of second draft of articles 1-27 of model law on procurement (A/CN.9/WG.V/WP.28)

Article 1 Application of Law

11. It was generally agreed that the application of the Model Law should be as broad as possible so as to achieve the greatest degree of uniformity in the law relating to procurement. To that end, the Working Group agreed that the word "all" should be added to the opening provision

¹Report of the United Nations Commission on International Trade Law on the work of its nineteenth session, *Official Records of the General Assembly, Forty-first Session, Supplement No. 17 (A/41/17)*, para. 243.

²A/CN.9/WG.V/WP.22.

³A/CN.9/315, para. 125.

⁴A/CN.9/331, para. 222.

⁵*Official Records of the General Assembly, Forty-fifth Session, Supplement No. 17 (A/45/17)*, para. 29.

of article 1, so that the provision would read along the following lines: "This Law applies to all procurement by procuring entities."

12. It was recognized, however, that some States might be reluctant to adopt the Model Law without the ability to exclude its application to certain types of procurement. In particular, it was said that States should be able to exclude procurement in cases where national defence or national security was involved, and possibly in other cases involving important national interests. An opposing view was that providing for exclusions from the application of the Model Law ran counter to the objective of uniformity of law.

13. The national security exclusion presently appearing in paragraph (2) of article 1 was regarded as too narrow, since it referred only to procurement for national security or national defence "purposes" and did not cover other cases involving national security or national defence (see also paragraphs 225 and 226 below).

14. It was agreed that a State should be able to exclude the application of the Model Law to particular types of procurement in a general manner, e.g., by setting forth the exclusions in article 1 of the Model Law enacted by it or in the procurement regulations, or on a case-by-case basis. Exclusions on a case-by-case basis should not be made in a secretive or informal manner. It was also agreed that a procuring entity should be able to apply the Model Law to procurement that fell within an exclusion if the entity wished to do so. In order to promote transparency, the applications of the Model Law in such cases should be brought to the attention of the contractors and suppliers in the tender solicitation documents.

Article 2 *Definitions*

15. It was observed that several of the definitions in this article served to delineate the scope of application of the Model Law. It was agreed that those definitions should be drafted as broadly as possible so as to maximize the coverage of the Model Law and thus promote uniformity of law.

16. It was stated that careful consideration should be given to whether some of the definitions provided in the article were necessary. Definitions that merely referred to other articles of the Model Law were said to be unnecessary. It was said that, in principle, definitions should be provided only when needed to assist the user of the Model Law in understanding its provisions, or to define terms of art that could be wrongly interpreted if not defined.

17. Reference was made to the importance of aligning the definitions provided in the article with the substantive provisions of the Model Law in which the defined terms were dealt with in order to avoid conflicts between the definitions and the substantive provisions. To deal with the possibility of such conflicts, a proposal was made to

add a provision establishing, in the event of an inconsistency, whether the definition or the substantive article was to prevail. The proposal was not adopted. A provision of that nature was said to be unknown in the legislative practice of many States. In addition, it was observed that definitions should be drafted so as not to conflict with substantive articles. It was noted that in the final stages of the drafting of the Model Law the definitions would have to be re-examined to ensure their consistency with the substantive articles.

18. A view was expressed that the *chapeau* of the article should be changed to read, "In this Law".

"Procurement" (new subparagraph (a))

19. It was agreed that the definition of "procurement" should read along the following lines:

" 'Procurement' means the acquisition by any means, including by purchase, rental, lease or hire-purchase, of goods or construction, including services incidental to the supply of the goods or to the construction if the value of those incidental services does not exceed that of the goods or construction themselves, but not services in themselves."

20. The Working Group reaffirmed its earlier decisions (A/CN.9/331, para. 20; A/CN.9/315, para. 25) to deal at the present stage only with the procurement of goods and construction and not of services, except services that were incidental to the goods or construction being procured. It was noted that services were an important element of the Uruguay Round of trade negotiations currently being held under the auspices of the General Agreement on Tariffs and Trade (GATT), and it was said to be inappropriate to attempt to deal with services in the Model Law before those negotiations were completed. In addition, it was observed that, since services were not procured on the same basis or with the same procedures as goods and construction, additional provisions would have to be formulated for the Model Law if services were to be covered. In accordance with its decision not to deal with services, the Working Group agreed that the words "and the acquisition of telecommunications, transport or insurance services", that presently appeared at the end of the definition of "procurement", and the references to services that appeared elsewhere in the text, not be retained.

21. A view was expressed that the commentary to the Model Law should indicate whether the acquisition of goods or construction in the context of joint ventures, licensing, and other arrangements not specifically referred to in the definition of "procurement" were covered by the definition.

"Procuring entity" (subparagraph (a))

22. A proposal was made to not define "procuring entity" in the Model Law, but, instead, to indicate that each State should specify in an annex to the Model Law as enacted by it those entities that were to be covered by the Model Law. The proposal was not adopted. The prevailing view was that a definition of "procuring entity" along the lines presently provided in subparagraph (a) was useful

because it clarified that organs of the Government (referred to in subparagraph (a)(i)) as well as public and other entities that were not part of the Government (referred to in subparagraph (a)(ii)), were covered by the Model Law. In addition, by covering all organs of the Government except those specifically excluded, subparagraph (a)(i) was regarded as consistent with the policy of maximizing the coverage of the Model Law. In response to a view that a State should not be able to exclude any organs of the central Government from the coverage of the Model Law, it was observed that the ability to exclude certain organs was important for some States, and that those States might be reluctant to enact the Model Law if no exclusions were permitted.

23. It was agreed that the reference to "the administration" should be deleted from subparagraph (a)(i), as its meaning was not clear and it did not seem to add anything to the provision.

24. It was noted that subparagraph (a)(i) presented a difficulty in at least one country where governmental organs did not engage in procurement themselves, but, rather, did so through commercial enterprises owned by them. It was agreed that that situation could be addressed in the commentary to the Model Law.

25. A view was expressed that subparagraph (a)(i) should cover not only organs of the Government of the State enacting the Model Law, but also organs of governments of subdivisions of the State (e.g., governmental organs of units of a federation and of local units). In response, it was noted that, in some federal systems, the national Government could not legislate in respect of procurement for units of the federation or for local governmental units. However, units of the federation could adopt the Model Law themselves.

26. The Working Group considered various possible ways to cover in subparagraph (a)(i) organs of all levels of government and also to take account of the needs of federal States that could not legislate for governments of their subdivisions, but no satisfactory solution was found. Ultimately, the Working Group agreed to provide two alternative versions of subparagraph (a)(i). One version would cover all governmental organs, including governmental organs of subdivisions of a federation. It would be adopted by non-federal States and by federal States that could legislate for their subdivisions. The other version would cover only organs of the national Government; it would be adopted by federal States that could not legislate for their subdivisions.

27. A view was expressed that the criterion for determining whether an entity was to be covered by subparagraph (a)(ii) should be whether or not it engaged in procurement with funds provided by the Government. It was pointed out that in some States there were enterprises that in some cases engaged in procurement with funds provided by the State and in other cases engaged in procurement with their own funds. In response to that view it was generally agreed that the commentary should discuss the criteria that should be used for determining which entities should be covered by the subparagraph.

28. It was noted that a State might either specify categories of entities or identify specific entities to be covered by subparagraph (a)(ii).

"Goods" (subparagraph (b))

29. A proposal was made to refer in subparagraph (b) only to "moveable" goods, so as not to cover real property. It was pointed out, however, that the term "moveable" had particular juridical meanings in different legal systems, and that using the term might have unintended consequences in some legal systems.

30. With respect to the words within square brackets at the end of subparagraph (b), it was generally agreed that the reference to goods in solid, liquid or gaseous form should be retained. With respect to the references to energy, it was agreed that reference should be made only to electricity and not to nuclear or other energy. In that connection it was stated that only electricity itself, and the equipment that produced it, could be the subject of procurement.

31. A view was expressed that petroleum should be excluded from the definition of goods, as it was not purchased by procedures provided in the Model Law. It was noted that States where special rules for petroleum were needed could, in enacting the Model Law, determine how petroleum should be treated.

"Construction" (subparagraph (c))

32. It was generally agreed that subparagraph (c) be reformulated along the following lines:

"'Construction' means all work associated with the construction, reconstruction, demolition, repair or renovation of a building, structure or works, such as site preparation, excavation, erection, building, installation of equipment or materials, decoration and finishing, as well as drilling, mapping, satellite photography, seismic investigations and similar activities in connection with construction."

33. An opinion was expressed that activities such as drilling, mapping satellite photography and seismic investigation should be covered even if they were not connected with construction, since they were generally procured on the same basis and by means of the same procedures as goods and construction. The prevailing view, however, was that, without the link with construction, those activities might be regarded as services, which were not at the present stage to be dealt with in the Model Law; thus, the activities should be covered only where they were connected with construction.

"Procurement proceedings" (subparagraph (d))

34. Doubts were expressed as to whether the definition of "procurement proceedings" was needed. It was noted that the definition as presently formulated would be too restrictive if the Working Group were to decide to include in the Model Law types of proceedings in addition to those currently specified in the definition. It was decided

to delete the definition, recognizing that it would be possible to re-examine that decision if consideration of subsequent provisions of the Model Law revealed that a definition would be useful.

"International tendering proceedings"
(subparagraph (e))

35. Several difficulties were said to arise with respect to the definition of "international tendering proceedings" contained within square brackets in article 2(e). It was said that the definition gave rise to difficulties, for example, with respect to its application in the case of a contractor and supplier that had established a residence in a State solely to benefit from the State's advantageous taxation provisions, and in the case of a contractor or supplier that had places of business in more than one State. In the case of a contractor or supplier that was organized as a corporation, the definition gave rise to questions as to whether it referred to the State of incorporation, or to the States where the officers or shareholders had their residences or places of business. It was also pointed out that some States imposed different rules for determining who was a national of the State depending on the purpose for which nationality was relevant. In addition, the words "encourage and promote" were said to constitute statements of policy rather than legal norms. Various proposals were made with the aim of improving the definition, including a proposal that the reference to "habitual residences" be deleted and proposals directed at making the reference to places of business more specific.

36. It was questioned whether a definition of "international tendering proceedings" was necessary at all. In that connection, the Working Group considered the role of the term in the Model Law and the relationship among articles 2(e), 3(b) and 11. It was noted that, as provided in article 3(b), an underlying objective of the Model Law was to foster and encourage participation in procurement proceedings by competent contractors and suppliers, including, where appropriate, by what were referred to generally as "foreign" contractors and suppliers. It was observed that the Model Law provided various special procedures to be used in tendering proceedings when participation in those proceedings by "foreign" contractors and suppliers was to be fostered and encouraged. The function of article 11 was to establish when those special procedures were to be used.

37. The term "international tendering proceedings" was used in article 11 as a convenient way to refer to tendering proceedings involving the use of those special procedures. That usage of the term "international tendering proceedings" formed the basis of the definition that was contained in article 2(e).

38. In view of the close relationship between article 2(e) and article 11, the Working Group decided to defer further discussion of article 2(e) until it reached article 11, when the two articles would be considered together. At that stage the question of whether a definition of "international tendering proceedings" was needed, and, if so, its content could be reviewed. That subsequent discussion is reflected in paragraphs 118 to 120 below.

"Tender security" (subparagraph (f))

39. A proposal was made to delete the definition of "tender security". The definition was said to be unnecessary in view of the fact that the nature of the security required by the procuring entity would be stipulated in the tender solicitation documents. However, the definition was found to be acceptable in substance, subject to certain modifications and clarifications.

40. It was questioned whether the examples of types of tender securities listed in the definition were necessary. The prevailing view was that the examples were useful. It was agreed that a reference should be made to additional types of instruments that were used as securities, such as stand-by letters of credit, surety bonds, promissory notes and bills of exchange. It was also agreed that the reference to financial institutions should be deleted, since some types of tender securities were issued by institutions that in some States may not be regarded as financial institutions (e.g., by insurance companies).

41. In the light of the foregoing discussion, the following definition of tender security was found to be generally acceptable:

"'tender security' means a security for the performance of the obligations of a tenderer, including such arrangements as guarantees, surety bonds, letters of credit, stand-by letters of credit, cheques on which a bank is primarily liable, cash deposits, promissory notes and bills of exchange."

"Currency" (subparagraph (g))

42. The Working Group found the definition of "currency" to be generally acceptable.

"Tendering proceedings" (subparagraph (g bis))

43. The Working Group found the definition of "tendering proceedings" to be generally acceptable.

"Competitive negotiation proceedings"
(subparagraph (h))

44. The definition presently set forth within square brackets was said to present the danger of conflicting with article 34. Pursuant to that view, a suggestion was made that the words within square brackets should be deleted and that the definition should simply refer to article 34. In opposition to that suggestion, it was said such a definition would serve no purpose.

45. The prevailing view was that the definition presently set forth within square brackets provided useful information to the user of the Model Law. It was agreed, however, that the wording should be expanded so as to refer to negotiations on a competitive basis between the procuring entity and "at least two" contractors and suppliers.

"Single source procurement" (subparagraph (i))

46. The Working Group found the definition of "single source procurement" to be generally acceptable.

"Contractor or supplier" (subparagraph (i bis))

47. A question was raised as to the suitability of the term "contractor", since a person or enterprise would not become a "contractor" until it entered into the procurement contract. It was agreed, however, that since the definition referred to "any potential party" to a procurement contract the definition was satisfactory.

"Responsive tender" (subparagraph (j))

48. It was generally agreed that the opening words of the definition should be changed to read along the following lines: " 'Responsive tender' means a tender that . . .".

49. It was observed that, in providing that a tender was responsive if it conformed to the requirements of the tender solicitation documents, the definition was inconsistent with article 28(4), which contained an exception to the necessity for conformity to the tender solicitation documents. To remedy that inconsistency, it was agreed that a reference to article 28(4) should be added to the definition. It was also agreed that the definition should be modified so as to refer to conformity with "all" requirements set forth in the tender solicitation documents.

50. A proposal was made that the definition should refer to "mandatory" requirements of the tender solicitation documents, in order to distinguish specifications or stipulations in the tender solicitation documents to which tenders must conform from those to which tenders need not conform and in respect of which tenderers might make offers to enhance their tenders. The proposal was not accepted because the word "requirement" itself implied that conformity was mandatory.

51. It was agreed that the words at the end of the definition beginning with "including requirements concerning" were superfluous and should be deleted.

52. In the light of the foregoing discussion, it was generally agreed that the definition should be reformulated along the following lines:

" 'Responsive tender' means a tender that conforms to all requirements set forth in the tender solicitation documents, subject to article 28(4)."

Article 3
Underlying objectives

53. It was agreed that the word "objectives" appearing within square brackets in the *chapeau* of article 3 should be retained.

54. A view was expressed that the statement of objectives should be retained in article 3. It was generally agreed, however, that since the statement of objectives of the Model Law presently set forth in article 3 did not create substantive rights or obligations for parties, it should be set forth in a preamble to the Model Law rather than in the body of the Law itself.

55. It was noted that, as article 3 was presently formulated, the objective of economy in procurement, set forth

in paragraph (a), was subordinate to the objective of efficiency, which was set forth in the *chapeau*. It was generally agreed that the objectives of economy and efficiency should be given equal status by removing the reference to efficiency from the *chapeau* and placing it in subparagraph (a), which would read, "to maximize economy and efficiency in procurement".

56. A view was expressed that the word "economy" that was used in the phrase "economy in procurement" in subparagraph (a), and the word "economic" used in the phrase "most economic tender" in article 28(7)(c), were unclear, and it was questioned whether the two words were intended to convey the same meaning. It was also said that both words should be defined. In response, it was stated that "economy in procurement" was a general term that referred to the procuring entity's obtaining the best value in the procurement, while "most economic tender", as defined in article 28(7)(c), referred to the two optional criteria to be used by the procuring entity for selecting the successful tender, namely, the tender with the lowest price or the lowest evaluated tender. It was also believed that no confusion between the terms "economy in procurement" and "most economic tender" was likely to arise, especially once the objective of economy in procurement was moved to the preamble.

57. It was agreed that the statement of the objectives of the Model Law should be expanded and should include a reference to the objective of promoting international trade.

58. It was agreed that the reference in subparagraph (b) to participation by contractors and suppliers whose places of business or habitual residences were located outside the enacting State would have to be aligned with the results of the consideration by the Working Group of the definition of "international tendering proceedings" in article 2(e). With respect to subparagraph (c), a view was expressed that the words "to promote competition between contractors and suppliers" should be changed to "to promote equal competition between contractors and suppliers".

Article 3 bis
International agreements or other international obligations of this State relating to procurement

59. There was general agreement with the rule in article 3 bis that, if the Model Law conflicted with a treaty entered into by a State enacting the Model Law, the treaty would prevail. Objection was expressed, however, to the rule whereby, in the event of a conflict of the Model Law with agreements between the enacting State and organs of other States, or with agreements between the enacting State and international financing institutions, those agreements would prevail over the Model Law. It was said that such agreements should not be treated in the same manner as treaties. It was noted that the rule that the agreements were to prevail conflicted with the principle in some legal systems that courts must apply national legislation even if that legislation was inconsistent with the State's international obligations. It was also said that the effect of the rule would be to authorize executive departments to enter

into agreements that abrogated legislation enacted by parliament, which would not be acceptable in some countries. Finally, it was stated that it would often be possible for States, in negotiating agreements with financing institutions, to avoid conflicts between those agreements and the Model Law enacted by the States.

60. The prevailing view was that the rule that international agreements were to prevail should be retained. The rule was said to be consistent with constitutional and legal principles in many legal systems, and reflected practice in connection with financing by international financing institutions. It was common for a borrowing State to agree that its loan agreement with the international financing institution would prevail over inconsistent provisions of national law. Such loan agreements were usually ratified by the parliaments of the borrowing States and were said to be in the nature of treaties. Thus, the agreements would, as a matter of law, usually prevail over inconsistent provisions in national legislation. Nevertheless, the express rule to that effect in article 3 *bis* was desirable in that it would prevent uncertainty on the part of procurement officers as to whether the agreement or the Model Law would prevail and would prevent consequent delays in procurement. It was stated that the concerns that some States might have about the conclusion by the executive branch of government of an agreement that prevailed over a law enacted by the parliament could be alleviated somewhat if the States were to designate in their procurement regulations the governmental organs that were authorized to enter into agreements with financing institutions.

61. It was pointed out that, according to the final phrase of article 3 *bis*, agreements with organs of other States and with international financing institutions would not completely replace the Model Law, but would apply only to the extent of a conflict with the Model Law. A view was expressed that, in order to emphasize the presumption of the applicability of the Model Law, article 3 *bis* should be redrafted to state that all procurements were to be governed by the Model Law, except to the extent that the Model Law conflicted with treaty or other international obligations of the enacting State.

62. It was agreed that article 3 *bis* should be modified so as to clarify that only agreements with governmental international financing institutions, and not agreements with non-governmental institutions, would prevail over inconsistent provisions of the Model Law. A proposal to expand the article to refer to agreements with all international institutions was not accepted. It was also agreed that the article should refer not only to obligations "under" treaties or agreements entered into by States but also obligations "arising out of" such treaties and agreements, in order to ensure that, for example, directives of the European Community (EC), which were promulgated pursuant to the EC Treaty, would prevail over inconsistent provisions of the Model Law.

63. A question was raised as to whether it was appropriate for article 3 *bis* to provide that not only existing treaties and agreements, but also future ones, prevailed over inconsistent provisions of the Model Law. That feature of article 3 *bis* was generally found to be acceptable.

Article 4 ***Procurement regulations***

64. It was agreed that article 4 should be modified to take into account provisions of the procurement regulations excluding the application of the Model Law to certain types of procurement (see paragraph 14 above).

Article 5 ***Public accessibility of procurement law, procurement regulations and other legal texts relating to procurement***

65. The Working Group found article 5 to be generally acceptable.

Article 6 ***Control and supervision of procurement***

66. It was observed that, in some States, the organ that was to approve acts and decisions of the procuring entity might vary depending upon the act or decision in question. Accordingly, the Working Group decided to delete article 6, which vested in a single organ authority to approve all acts and decisions that were subject to approval. It also decided that each article dealing with an act or decision that was subject to approval should designate the organ that was to exercise the approval function. In order to enable a State to change the organ without having to amend the Model Law enacted by the State, it was suggested that the State should be able to change the organ by designating the new organ in the procurement regulations.

67. It was noted that the approval of acts and decisions of the procuring entity by another administrative authority was contrary to practice in some States. It was accepted that such States could delete references to the approval function when they enacted the Model Law.

Article 7 ***Methods of procurement and conditions for their use***

68. The Working Group agreed with the approach presently reflected in paragraph (1), namely, that tendering was the preferred method of procurement.

69. With respect to paragraph (2), differing views were expressed as to the desirability of providing in the Model Law for procurement by competitive negotiation. According to one view, it was dangerous to provide for that method of procurement since it gave the procuring entity broad and uncontrolled freedom to negotiate with contractors and suppliers in any manner that it saw fit. In the absence of any procedural structure to control the negotiating process, the negotiations could potentially be engaged in by the procuring entity in a commercially inappropriate manner. Furthermore, no objective criteria were provided with respect to the selection of the contractor or supplier with which the procurement contract would

be concluded. Such criteria were said to be important in order to provide guidance to the procuring entity with respect to the negotiations, and to provide standards against which the decision of the procuring entity could be evaluated by an approving authority or in proceedings instituted for review of the decision. In short, the method was said to lack transparency and to be open to abuse. The view was also expressed that other, more appropriate, methods of procurement were available for procurement in the situations in which it was contemplated that competitive negotiation would be used.

70. The prevailing view was that competitive negotiation should be retained in the Model Law. It was said to be used in practice in several countries. It was also said to be the most appropriate method of procurement in certain cases, for example, in the procurement of goods or construction with a substantial technological component; thus it should be made available to procuring entities. Control could be exercised over the use of competitive negotiation by requiring the procuring entity to obtain approval for the use of that method from a higher supervisory authority or by subjecting its use to other methods of control and supervision. It was noted that, in some countries, administrative control over procurement was exercised by means of audit procedures after the procurement proceedings. It was questioned, however, whether that was an adequate method of control over the conduct of the proceedings. It was agreed that the conditions set forth in paragraph (2) as to when competitive negotiation could be used were not appropriate and should be revised.

71. The Working Group agreed that single source procurement, provided for in paragraph (3), should be retained in the Model Law. It also agreed that the method of procurement presently referred to in article 31 as two-stage tendering proceedings should be retained, but should be provided for in the Model Law as a separate method of procurement, and should not be dealt with in the section of the Model Law dealing with tendering proceedings.

72. It was generally agreed that the present draft of the Model Law did not provide a sufficient range or variety of appropriately differentiated methods of procurement to meet the needs of procuring entities. It was agreed, therefore, that additional methods should be provided, namely, request for proposals, to be used in cases where the procuring entity sought a variety of proposals for meeting its procurement need, and request for quotations, to be used for relatively low value procurement of readily identifiable goods.

73. As to the structure of article 7, the Working Group considered two possible approaches. Under one approach, article 7 would list each of the procurement methods provided by the Model Law and describe the conditions under which each method could be used. Under the other approach, the conditions for the use of the various methods would be set out in the articles of the Model Law dealing with those methods.

74. The Working Group appointed an ad hoc Working Party to consider the content and structure of article 7 in

the light of its discussion and decisions. The ad hoc Working Party was requested to elaborate conditions for the use of procurement methods other than tendering and the procedures involved in those methods. The following paragraphs reflect the discussion and decisions of the Working Group based on the recommendations of the ad hoc Working Party. The Secretariat was requested to take account of the discussion and decisions in preparing the next draft of the Model Law.

75. It was agreed that article 7 should contain a listing of all methods of procurement provided for in the Model Law. They would be: tendering, two-stage tendering, request for proposals, competitive negotiation, request for quotations and single source procurement. The conditions under which each method could be used, and the procedures involved in those methods, would be set out in individual articles of the Model Law dealing with each method. It was also agreed, subject to the decision of the Working Group concerning the treatment in the Model Law of the approval function, to provide that the decision of the procuring entity to use a method of procurement other than tendering would be subject to approval. The question of which organ would give such approval would be left to each State.

76. It was observed that the issue of whether tendering proceedings were to be open to contractors and suppliers without regard to nationality was dealt with in article 11. It was agreed that the issue of such participation in other methods of procurement should be dealt with in the articles dealing with each of those methods.

77. It was observed that the conditions under which a procuring entity would be entitled to engage in limited tendering proceedings was dealt with in article 12(2). The Working Group agreed that the Model Law should also deal with the conditions under which participation in proceedings involving other methods of procurement could be limited to particular contractors and suppliers chosen by the procuring entity.

Tendering proceedings

78. With respect to tendering proceedings, it was agreed that the substance of article 7(1) should be retained.

79. It was noted that, when the use of a method of procurement other than tendering proceedings was justified, the circumstances of a particular procurement might justify the use of more than one such method. For those cases, it was agreed that the following order of preference should be established: (i) two-stage tendering; (ii) request for proposals; (iii) competitive negotiation; (iv) request for quotations; (v) single source procurement.

Two-stage tendering

80. It was agreed that the conditions for use and procedures for two-stage tendering should be in essence those presently provided in article 31, with appropriate modifications made to take into account that the method was to be a separate method.

Request for proposals

81. It was agreed that the procuring entity should be entitled to use the request for proposals method when it had not identified a particular solution to its procurement need and required proposals as to various possible solutions. The Working Group did not accept a proposal to limit the use of that method to cases in which the use of two-stage tendering was not practicable.

82. As to the procedures to be followed in procurements involving this method, the procuring entity would request from contractors and suppliers proposals as to the means of solving its procurement need. The selection of the contractor or supplier with which to enter into a procurement contract would be based not only on price but also on other objective and quantifiable criteria. The evaluation of the proposals would involve the use of a list of weighted criteria, which would be clearly disclosed to contractors and suppliers. Contractors and suppliers would also be informed of the relative weights of the criteria to be used. The criteria would measure both the competence of the contractor or supplier submitting the proposal and the effectiveness of its proposal in meeting the procuring entity's procurement need. The effectiveness of the proposal would be evaluated separately from the price.

83. Disagreement was expressed with the requirement that the criteria for the selection of the contractor or supplier with which to enter into the contract had to be objective and quantifiable. It was noted that, for the procurement of some types of goods, such as computer systems, it was not possible to establish quantifiable criteria. In the circumstances in which the request for proposals method was designed to be used, it was frequently necessary for the evaluation process to contain a subjective element. In response to the suggestion that the request for proposals method should be adapted to the procurement of computer systems, it was pointed out that, because of the particular nature of those systems, special rules and procedures were being developed in practice for their procurement.

84. Disagreement was also expressed with the feature of the request for proposals method, contained in the formulation agreed to by the Working Group, that the competence of contractors and suppliers was to be evaluated together with the effectiveness of the proposal. It was stated that the competence of contractors and suppliers should be evaluated separately, and in accordance with precise and objective criteria of the type presently contained in article 8. It was said that to permit the procuring entity to evaluate the competence of contractors and suppliers together with the effectiveness of the proposal could introduce a subjective element in the evaluation of the effectiveness of the proposals, which would be undesirable.

Competitive negotiation

85. It was agreed that a procuring entity should be entitled to engage in procurement by means of competitive negotiation in the following circumstances:

(a) when, due to the nature, scope or volume of goods or construction, and in order to obtain the most satisfactory solution to its procurement needs, it is necessary to negotiate with contractors or suppliers in order to enable the procuring entity to evaluate their responses to its needs and to obtain the solution which represents the best value;

(b) when there is an urgent need for the goods and tendering would therefore be impossible or imprudent;

(c) when the procuring entity seeks to enter into a contract for the purpose of research, experiment, study or development leading to the procurement of a prototype, except where the contract includes the production of goods and quantities sufficient to establish their commercial viability or to recover research and development costs; or

(d) when, for reasons of national defence or national security, there is a need for secrecy in respect of the procuring entity's procurement needs.

86. Disagreement was expressed with the circumstances referred to in subparagraphs (a) and (b) of paragraph 85, above. It was proposed that those circumstances should be narrowed so as to permit competitive negotiation to be used:

(a) when no other method of procurement was applicable, or the use of another method of procurement failed to result in a procurement contract because of a lack of responsive tenders or offers by qualified contractors or suppliers, or the selected contractor or supplier failed to enter into a procurement contract;

(b) when there was a special emergency, not created or suffered by the procuring entity, resulting in an urgent need for the goods or construction and it would not be possible to satisfy that need by any other methods of procurement.

87. It was said that such a formulation defined more concretely and clearly the circumstances in which competitive negotiation could be used, and would help ensure that that method of procurement, which was subject to few controls, would be used only when it was appropriate. It was also stated that the proposed formulation was in line with the stricter conditions for the use of competitive negotiation found in the directives issued by the Commission of the European Communities concerning procurement of supplies and public works. The proposal was not adopted. The formulation in the proposal of the circumstances in which competitive negotiation could be used was found to be too restrictive. The circumstances enumerated in paragraph 85, above, were found to be more consistent with practice in several countries and to meet the needs of procuring entities more satisfactorily. With respect to the circumstances mentioned in paragraph 86(a), above, it was pointed out that, in some situations, competitive negotiation might not be the only method of procurement available, but it might be the most appropriate method. It was said to be more desirable for those situations to be dealt with by the ranking system referred to in paragraph 79 than to prevent the competitive negotiation method from being used altogether. It was also said that the conditions for engaging in competitive negotiation

should relate to the nature of the procurement rather than to the failure of some other procurement method.

88. An objection was also raised to the formulation of the "emergency" situation in paragraph 86(b), above. It was said that preventing the procuring entity from using competitive negotiation when the emergency was imputable to the procuring entity was not in the public interest, and would make the Model Law unacceptable in some States.

89. It was agreed that the provisions of the Model Law concerning the procedures to be used for competitive negotiation should be along the lines of article 34 of the present draft.

Request for quotations

90. It was agreed that the request for quotations method should be used for the procurement of readily identifiable goods for which there was a commercial market. It would typically be used where the goods were of a relatively low total quantity and value.

91. With respect to the procedures to be followed in that method, the procuring entity would request quotations from several contractors and suppliers. It was suggested that, for procurements above a specified value, the procuring entity be obligated to advertise for price quotations. Each contractor and supplier would give one price quotation and would not be permitted to change its quotation. The procuring entity would not be permitted to negotiate with contractors and suppliers. The contract would be awarded to the contractor or supplier quoting the lowest price.

Single source procurement

92. The Working Group expressed general agreement with the conditions for the use of single source procurement set forth in article 7(3), and the procedures set forth in article 35.

Article 8

Qualifications of contractors and suppliers

New paragraph (1)

93. The Working Group found new paragraph (1) to be generally acceptable.

Paragraph (1)

94. Support was expressed for the approach of paragraph (1)(a)(i), which specified the national law that would govern the legal capacity of the contractor or supplier to enter into the procurement contract. That approach enabled the contractor or supplier to know whether or not it met the requirement of legal capacity and to submit the proper documentation to prove its capacity. As to the question of which State's law should apply, support was expressed for the law of the State of which the contractor or supplier was a national, as presently provided within

square brackets in paragraph (1)(a)(i). According to another view, the paragraph should refer to the law of the place of procurement.

95. The prevailing view, however, was that the paragraph should not specify the law of a particular State, but should leave that issue to be resolved by relevant conflict of laws rules, and that the words that presently appeared within square brackets in paragraph (1)(a)(i) should be deleted. In support of that view, it was pointed out that the law governing capacity to enter into a contract varied under the conflict of laws rules of different legal systems. It was stated that the Model Law should not attempt to unify those conflict of laws rules. It was also pointed out that it was not sufficient merely to designate the law of a particular State to govern the issue of capacity to enter into the contract, since it would be uncertain whether or not the designation included the conflict of laws rules of that State. If the designation did include conflict of laws rules, those rules might point to the law of some other State as governing the issue, and the question of whether or not a contractor or supplier had legal capacity might be resolved differently in the two States. It was also stated that not specifying which law was to govern the issue was unlikely to create any problems for contractors and suppliers, since disputes rarely arose concerning the question of capacity to enter into the contract. It was agreed that the commentary to the Model Law should discuss the various issues and problems that arose in connection with that question.

96. It was agreed that the word "receivership" within square brackets in paragraph (1)(a)(ii) should be retained.

97. The Working Group found paragraph (1)(a)(iii) to be generally acceptable.

98. A proposal was made that paragraph (1)(a)(iv) should be deleted for the reason that it was not possible in some countries for a contractor or supplier to obtain official certification that it had not been convicted of a criminal offence or held liable in civil proceedings. In response, it was noted that a contractor or supplier might submit to the procuring entity an affidavit to that effect. The utility of such an affidavit, however, was questioned, particularly if the procuring entity could not verify the information contained in it.

99. The Working Group decided to retain the reference in paragraph (1)(a)(iv) to convictions of contractors and suppliers of criminal offences, and the words within square brackets, "or based on the making of false statements or misrepresentations as to their qualifications to enter into a procurement contract". It was proposed that reference should also be made to false statements or misrepresentations concerning the products of contractors and suppliers. The proposal was not adopted. The meaning of "products" was found to be uncertain and it was pointed out that some States had laws concerning misrepresentation and false advertising which dealt with the issue adequately.

100. A view was expressed that it should be clarified whether the reference in paragraph (1)(a)(iv) to criminal

convictions referred to convictions of the contractor or supplier itself, or also of its principal personnel and officers.

101. The Working Group decided to delete from paragraph (1)(a)(iv) the words, "and have not been held liable in civil proceedings for loss arising from the performance or failure to perform a procurement contract". That criterion for disqualification was found to be too broad, as the fact that a contractor or supplier had been held liable in civil proceedings did not necessarily impugn its qualifications to perform the procurement contract.

102. A proposal was made that paragraph (1)(a)(vi) should be located more prominently in the article, as it set forth the most important criteria with respect to the qualifications of contractors and suppliers. The Working Group decided to retain the words "managerial capability, reliability, experience and reputation" that appeared within square brackets in the paragraph.

103. Objections were raised to the right of the procuring entity to inspect the books of contractors and suppliers, provided for within square brackets in paragraph (1)(b). In support of that provision, it was stated that the ability to inspect the books can provide the procuring entity with sound and reliable information concerning the qualifications of a contractor or supplier. It was noted that contractors and suppliers were safeguarded by the *chapeau* of paragraph (1), which contained the proviso, "subject to the right of contractors and suppliers to protect their intellectual property or trade secrets". After discussion, the Working Group agreed that the ability to inspect the books of contractors and suppliers should be deleted from paragraph (1)(b), and that, instead, contractors and suppliers should be required to provide such verification of their statements concerning their qualifications as the procuring entity may reasonably require.

Paragraph (2)

104. The Working Group found paragraph (2) to be generally acceptable.

Paragraph (2 bis)

105. The Working Group found paragraph (2 bis) to be generally acceptable.

Paragraph (2 ter)

106. A view was expressed that the prohibition of discrimination against foreign contractors and suppliers in connection with the criteria and procedures for evaluating their qualifications was formulated too broadly. It was said that the paragraph could be interpreted so as to prevent differential treatment of foreign and domestic contractors and suppliers to achieve socio-economic objectives, and to prevent a State from requiring contractors and suppliers to be incorporated in that State as a condition for participation in procurement proceedings. In response, it was stated that socio-economic factors should play no role in evaluating the qualifications of contractors and suppliers, and that the paragraph would not prohibit

laws requiring contractors and suppliers to be incorporated in the State as a condition for participation in procurement proceedings if foreign contractors and suppliers were given a reasonable opportunity to become incorporated there.

107. The Working Group decided that paragraph (2 ter) should be retained in its present form and that the concerns that had been expressed in opposition to the formulation of the paragraph should be addressed when the Working Group considered article 11. It also agreed that the reference to "foreign" contractors and suppliers would have to be modified to accord with the decision of the Working Group concerning the definition of "international tendering proceedings" in article 2(e), and that the words "discriminates against" foreign contractors and suppliers should be changed to "discriminates against or among".

Paragraph (3)

108. It was agreed that the words within square brackets, "subject to the efficient operation of the procurement system", should be deleted, as they provided too much scope for arbitrary exclusion of contractors and suppliers from procurement proceedings.

109. It was agreed that paragraph (3) should be modified so as to preclude its application where prequalification proceedings had been engaged in, since a contractor or supplier that was not prequalified should not be able to participate in procurement proceedings under this paragraph.

110. It was observed that the paragraph as presently formulated was ambiguous as to whether it applied only to contractors and suppliers that met the qualification criteria but had merely been unable to supply the requisite proof, or also to contractors and suppliers that did not meet the criteria but wished to take steps to do so during the procurement proceedings. The Working Group agreed that the formulation should be clarified so that the paragraph would apply only to contractors and suppliers that met the qualifications criteria but had been unable to supply the requisite proof, perhaps by replacing the word "demonstrate" with "provide proof". It was also agreed that the paragraph should clarify that the contractor or supplier must submit the proof prior to the end of the procurement proceedings.

Article 10

Rules concerning documentary evidence provided by contractors and suppliers

111. Views were expressed that article 10 should be deleted. The article was said to be too detailed, and presented the danger of being used by a procuring entity to exclude a contractor or supplier from participation in the procurement proceedings on the basis of a failure by the contractor or supplier to comply with a formality specified in the article. In addition, it was observed that many States had laws concerning the legalization of documents, and those States could not be expected to adopt separate rules for documents used in procurement proceedings. It was

suggested that the issues dealt with in the article should be discussed in the commentary.

112. Support was expressed for the article in principle, as it would help prevent the procuring entity from excluding a contractor or supplier unfairly on the basis of a formality. However, paragraphs (2) and (3) were found to be too detailed. In addition, it was observed that the notarial function, referred to in paragraph (2), did not exist in all States, and that the paragraph lacked reference to various other categories of persons who had authority to certify documents, such as accountants. The utility of paragraph (3)(b) was also questioned.

113. The Working Group decided to retain paragraph (1), including the words "when the procuring entity requires that the documentary evidence be legalized". Those words ensured that the article would not be interpreted as requiring all documents provided by contractors and suppliers to be legalized, and clarified that the rules in the article would apply only when the procuring entity required a document to be legalized. In substitution for paragraphs (2) and (3), it was agreed that the article should provide that the procuring entity did not have the authority to impose any requirements as to the legalization of documentary evidence of the qualifications of contractors and suppliers other than requirements provided for in laws of the State enacting the Model Law relating to the legalization of documents of that type.

Article 11

International tendering proceedings

114. Support was expressed for the approach presently reflected in article 11, according to which the decision of whether or not to engage in international tendering proceedings was left to the discretion of the procuring entity. According to other views, however, the procuring entity should be required to engage in international tendering proceedings in certain cases, such as when the goods or construction to be procured exceeded a certain monetary value, or when engaging in such proceedings was necessary in order to achieve economy and efficiency in the procurement.

115. It was noted that the first draft of article 11 had contained an additional paragraph stipulating that the procuring entity was required to engage in international tendering proceedings when the goods or construction to be procured exceeded a certain monetary value, unless it obtained approval not to engage in international proceedings (A/CN.9/WG.V/WP.24, article 11(2)). It was said that, with the deletion of that paragraph pursuant to the decision of the Working Group at its eleventh session (A/CN.9/331, para. 58), the article was deprived of much of its function, namely, to establish when the procuring entity was to engage in international tendering proceedings. In its present form, the article merely stated the obvious, i.e., that the procuring entity "may" engage in international tendering proceedings. It was also said that the article could be given the undesirable interpretation that domestic tendering proceedings were the norm and

the procuring entity had to justify the use of international tendering proceedings as an exception.

116. The prevailing view favoured an approach to article 11 whereby there would be a presumption in favour of the use of international tendering proceedings, except where engaging in international proceedings would be contrary to the objectives of economy and efficiency or could be avoided on grounds specified in the procurement regulations. Each State enacting the Model Law would be able to specify its own grounds based upon its needs and circumstances. The requirement that the grounds had to be specified in the procurement regulations would promote transparency. A view was expressed that the presumption favouring the use of international proceedings should apply not only to tendering proceedings but also to other methods of procurement provided for in the Model Law.

117. A concern was expressed that the approach agreed upon did not provide sufficient guidance to States or procuring entities in determining when international tendering proceedings should be used. It was noted that the Model Law was being prepared for use by States worldwide, and such guidance was said to be of particular importance to countries that had little experience with international procurement. To meet that concern, it was stated that guidance could be provided in the commentary.

118. In connection with its discussion of article 11, the Working Group further considered the definition of "international tendering proceedings" in article 2(e). It was suggested that the difficulties with respect to the definition that had been raised during the earlier discussion of article 2(e) (see paragraphs 35 to 38 above) might be avoided by reformulating article 11 in a manner that did not involve the use of the term "international tendering proceedings". Accordingly, the Working Group decided that there was no need to retain the definition in article 2(e).

119. It was noted that the term was used in the Model Law as, in essence, a convenient way to refer to various special procedures, provided for in the Model Law, designed to make tendering proceedings conducive to participation by foreign contractors and suppliers. Those special procedures were to be used in tendering proceedings in the cases mentioned in article 11.

120. Based on the general approach upon which it had agreed with respect to article 11, the Working Group decided to reformulate the article along the following lines. The article would specifically refer to all special procedures that were encompassed within the term "international tendering proceedings" and would require the procuring entity to employ those special procedures in tendering proceedings, except where their use would be contrary to the objectives of economy or efficiency or to other grounds specified in the procurement regulations. Contractors and suppliers would be permitted to participate in those tendering proceedings without regard to nationality, except where, upon the grounds mentioned above, the procuring entity decided to permit only domestic contractors and suppliers to participate. Each enacting State would define "domestic" in accordance with its own

laws concerning nationality. Contractors and suppliers from particular States could also be excluded for other lawful reasons.

121. It was agreed that the Model Law should require the procuring entity to specify in the invitation to prequalify or in the invitation to tender whether the tendering proceedings were open to participation by contractors and suppliers regardless of nationality, or whether there were any restrictions with respect to the nationalities of the contractors and suppliers. Furthermore, it was agreed that the procuring entity should not be able to change a declaration that the tendering proceedings were open to participation by contractors and suppliers without regard to nationality and that the entity should be required to conduct the tendering proceedings in accordance with the declaration. It was agreed that article 14 was the appropriate location for such a provision.

Article 12 *Solicitation of tenders and* *applications to prequalify*

Paragraph (1)

122. It was agreed that the term "notice of proposed procurement", which in the present draft of the Model Law referred both to the medium by which applications to prequalify were solicited and the medium by which tenders were solicited, should be replaced by the separate terms "invitation to prequalify" and "invitation to tender".

123. It was agreed that the first sentence of paragraph (1) should be reformulated so as to avoid the implication that an invitation to prequalify and an invitation to tender must be published simultaneously, perhaps by using the words "solicit tenders or, where applicable, applications to prequalify". It was noted that, where prequalification proceedings were used, no invitation to tender would be needed since contractors and suppliers that were prequalified would automatically receive the tender solicitation documents and would be entitled to submit tenders.

124. A view was expressed that the phrase "language customarily used in international trade" was vague, and that greater precision should be provided with respect to the language in which the invitation to prequalify or the invitation to tender must be published when tendering proceedings were open to contractors and suppliers regardless of nationality. It was proposed that each State should specify in the procurement regulations the languages to be used. In opposition, it was stated that the proposed approach was unsatisfactory because a State might specify languages that were not widely understood. It was stated that the question of which language was to be used did not result in problems in practice, since it was in the interest of the procuring entity to use a language that was widely understood and that was appropriate for the procurement in question. After discussion, the Working Group agreed that the reference to "a language customarily used in international trade" should be retained and that issues concerning the languages of publication,

including the desirability of widespread dissemination and understanding of invitations to tender and invitations to prequalify, should be discussed in the commentary.

125. A view was expressed that the words "of wide international circulation" were an insufficiently precise categorization of the types of newspapers and other publications in which invitations to prequalify or invitations to tender were to be published. A proposal that the publications in which the invitations were to be published should be specified by an enacting State in an annex to the Model Law was not adopted, as it was found to be difficult to implement and potentially too rigid. Accordingly, the Working Group decided to retain the words "of wide international circulation", but to clarify that they referred both to newspapers and to trade publications and technical journals.

126. The Working Group decided that the sentence within square brackets at the end of paragraph (1) that read, "The foregoing provisions do not preclude the use of additional means of bringing the notice of proposed procurement to the attention of contractors and suppliers", should be deleted, and that the purport of the words should be expressed by stating that the invitations must be published, "at a minimum", in the publications referred to in the second sentence of the paragraph.

127. It was understood by the Working Group that nothing in article 12 or elsewhere in the Model Law prevented an enacting State from restricting, pursuant to international agreements of the enacting State, participation in procurement proceedings to contractors or suppliers from certain States or regions or from excluding contractors and suppliers from certain States, and that article 3 *bis* adequately gave effect to that understanding.

Paragraph (2)

128. A suggestion was made that the word "communicating" should be changed to "given" in order to avoid an implication that the invitation to prequalify or the invitation to tender must be received by the contractors and suppliers.

129. It was observed that both alternative versions of subparagraph (a) combined, on the one hand, the circumstances in which participation in tendering proceedings could be limited to certain contractors and suppliers, and, on the other hand, the rules concerning the selection of contractors and suppliers to participate and the manner in which tenders were to be solicited from them. It was proposed that the circumstances in which participation could be limited should be dealt with in article 7.

130. The Working Group decided to adopt alternative 1 of subparagraph (a). Alternative 2 was found to be too detailed and complex, and its content was adequately covered by alternative 1. It was agreed that the substance of alternative 2 should be discussed in the commentary. A proposal was made to use the words "limited participation", rather than "restricted participation," in order to avoid an unintended implication that the subparagraph dealt with restrictions on participation in tendering

proceedings to contractors or suppliers from certain States (see paragraph 6 above).

131. It was agreed that subparagraph (b) should be retained, subject to certain drafting improvements, e.g., with regard to the word "communication", and deletion of the reference to services.

Article 14

Contents of notice of proposed procurement

132. It was noted that the terminology used in article 14, such as "notice of proposed procurement" and "solicitation documents", would have to be changed in accordance with previous decisions of the Working Group.

133. It was agreed that subparagraphs (i) and (j) should be deleted from paragraph (1).

134. It was noted that the declaration as to whether or not the tendering proceedings were open to contractors and suppliers regardless of nationality (see paragraph 121 above) would have to be added to the listing in paragraph (1) of the information to be included in the invitation to prequalify and the invitation to tender.

135. While paragraph (2) was found to be generally acceptable, it was questioned whether it was necessary or appropriate to require certain of the types of information listed in paragraph (1), and incorporated by reference into paragraph (2), to be included in the invitation to prequalify. Some of that information, such as the deadline for submitting tenders, might not yet be known when the invitation to prequalify was issued. The necessity to state in the invitation to prequalify the price of the tender solicitation documents was also questioned. The Secretariat was requested to review paragraph (2) in light of those observations.

Article 16

Prequalification proceedings

136. A view was expressed that the placement of article 16 should be reconsidered, since, chronologically, prequalification proceedings took place prior to the solicitation of tenders, which was dealt with in article 12. According to another view, the Model Law should provide for prequalification proceedings not only in connection with tendering proceedings, as was the case in the present draft, but also in connection with other methods of procurement, such as competitive negotiations and requests for proposals. The views expressed were referred to the Secretariat for further consideration.

137. An observation was made that the cross-references that appeared in this and other articles complicated the text, and their usefulness was questioned. It was also stated that the wording of some cross-references should be reconsidered. It was generally agreed that the cross-references were useful and should be retained, and the Secretariat was requested to ensure consistency by including cross-references wherever relevant in the text.

138. It was stated that a degree of duplication existed among articles 8, 14 and 16, and the Secretariat was requested to consider the possibility of consolidating duplicated provisions.

139. It was agreed that the sentence within square brackets that read, "However, prequalification proceedings shall not be engaged in where participation in tendering proceedings is restricted pursuant to article 12(2)" should be deleted, since the procuring entity should be able to use prequalification proceedings even in the case of limited tendering.

140. A proposal to delete the final sentence, which appeared within square brackets, was regarded as a matter of drafting, and was left to be considered at the final drafting stage.

Paragraph (2)

141. Paragraph (2) was found to be generally acceptable, subject to possible consideration, at the final drafting stage, of the necessity of the words "a set of".

Paragraph (3)

142. Concern was expressed about the degree of detail that was contained in this paragraph and in other provisions of the Model Law. It was said that excessive detail could prejudice enactment of the Model Law in some States and thus defeat the objective of uniformity of law.

143. There was general agreement that the detailed requirements that had been included in the present draft, such as those in paragraph (3), were necessary in order to achieve economy and efficiency, fairness and other objectives of the Model Law. They were essential elements of the procurement system established by the Model Law and therefore should be implemented by enacting States in a mandatory and normative form. However, it was stated that, in order to simplify the text and thus enhance its worldwide acceptability, it was preferable for those detailed requirements to be deleted from the text of the Model Law and left to be implemented by enacting States in the procurement regulations. The commentary could provide guidance to States in implementing those requirements in the regulations. According to a further view, the Commission could, in the commentary, strongly urge enacting States to implement the requirements in a mandatory and normative form.

144. The prevailing view was that the detailed requirements should not be deleted from the text of the Model Law. To do so would leave many provisions of the Model Law with little more than precatory language. If the requirements were not set forth in the Model Law itself, they might not be adopted in some States, and might not be adopted in a satisfactory manner in other States, defeating the objectives of the Model Law and prejudicing uniformity of law. The commentary, which would not have a normative legal status, could not ensure that the requirements would be adopted as expected by the Commission.

145. It was noted that retaining the detailed requirements in the text of the Model Law would not preclude a State from enacting those requirements in the form of regulations if it wished to do so, as long as the requirements were enacted in the form set forth in the Model Law. To assist such States, a suggestion was made that the text of the Model Law might somehow indicate which provisions might be suitable to be transposed into procurement regulations. The Secretariat was requested to consider possibilities along those lines.

146. It was observed that certain types of information required by paragraph (3) to be included in the prequalification documents were also required by article 14 to be contained in the tender solicitation documents. The Working Group reaffirmed the decision at its eleventh session that such duplication was useful and should be retained (A/CN.9/331, para. 74).

147. It was generally agreed that the opening words of the *chapeau* of paragraph 3, requiring that the prequalification documents contain "all information", be changed to "the" information. Requiring that the prequalification documents contain "all" information would give rise to the possibility of claims by contractors or suppliers that certain information had been omitted from the documents. It was suggested that wording should be used in the *chapeau* to the effect that the information listed in paragraph (3) was the minimum information to be given in the documents.

148. It was agreed that the word "plus" that appeared towards the end of the *chapeau* be changed to "including". It was noted that the words "except subparagraph (e) thereof" should be changed to read "except subparagraph (e) or (g) thereof", to correct a typographical omission. A proposal to terminate paragraph (3) after the phrase "submit applications to prequalify" in the *chapeau* was not adopted.

149. The Working Group agreed that subparagraph (b) should be deleted. It was said that the provision was dangerous, in that it would give rise to the possibility of claims by contractors and suppliers that certain information claimed to be encompassed by the provision had not been given in the prequalification documents. It was also said that, with the change of the word "all" to "the" in the *chapeau*, the substance of the provision was covered by the *chapeau*. A view was also expressed that the information called for by the provision was not necessary in prequalification proceedings.

150. In other respects, the Working Group found paragraph (3) to be generally acceptable.

Paragraph (3 bis)

151. It was generally agreed that the word "promptly" should be deleted from the first sentence, and that the sentence should be reformulated to require the contractor or supplier to make its request for clarification and the procuring entity to respond to the request within a reasonable time prior to the deadline for the submission of applications to prequalify, so as to enable the contractor or

supplier to take account of the response in its application prior to the deadline. To that effect, wording along the following lines was suggested: "The procuring entity shall respond to any request by a contractor or supplier for clarification of the prequalification documents, made within a reasonable time prior to the deadline for the submission of applications to prequalify, so as to enable the contractor or supplier to make a timely submission of its application to prequalify."

Paragraphs (4) and (5)

152. The Working Group agreed that the procuring entity should be required to inform each contractor and supplier whether or not it had been prequalified, as presently provided in the first sentence of paragraph (4). It was agreed, however, that the relevant portion of the sentence should be reworded so as to require the procuring entity to notify "each" contractor and supplier whether or not "it" had been prequalified.

153. Competing considerations were noted with respect to disclosure of the names of contractors and suppliers that had been prequalified. On the one hand, it was said that disclosure of that information to the general public would enable members of the public to provide the procuring entity with information that might be relevant to the qualifications of a contractor or supplier. It was stated, however, that disclosure of the information after the acceptance of a tender, as provided by the words within square brackets in paragraph (4), would be too late to enable members of the public to come forward with potentially relevant information. Furthermore, it was important for contractors and suppliers that had not been prequalified by the procuring entity to know at an early stage those contractors and suppliers that had been prequalified, since that information was relevant for a possible challenge of the decision of the procuring entity denying prequalification.

154. On the other hand, it was said that disclosure at an early stage of the names of contractors and suppliers that had been prequalified could facilitate collusion among contractors and suppliers in the tendering proceedings. Pursuant to that consideration, it was said that disclosure should not be made until after a tender had been accepted or, at the earliest, after the deadline for submission of tenders. In response, it was doubted whether non-disclosure of the information would prevent collusion. Furthermore, it was observed that there existed in several countries laws relating to fair competition which could deal with the problem of collusion, although it was pointed out that the law in that area was not well developed in all countries.

155. Based on the foregoing considerations various proposals were made. One proposal was to terminate paragraph (4) after the words, "whether or not they have been prequalified", allowing each enacting State to determine what further information should be disclosed, to whom and at what time. A second proposal was to delete the words within square brackets, "after a tender has been accepted", so as to require disclosure to the general public of the names of contractors and suppliers that had been prequalified. However, each enacting State should be

allowed to specify when that disclosure should be made. A third proposal was to require the procuring entity to provide the information on request to each contractor and supplier submitting a prequalification application, and to require the disclosure of the information to the general public only after a tender had been accepted. A fourth proposal was to allow the procuring entity flexibility with respect to the disclosure of the information, but to require it to specify in the prequalification documents what information would be disclosed, to whom and at what time. A fifth proposal was that the names of contractors and suppliers that had been prequalified should be disclosed only to those that had not been prequalified. The rationale of the proposal was to provide unsuccessful contractors and suppliers with information they might need to challenge the prequalification proceedings, and to prevent collusion among contractors and suppliers that had been prequalified. It was said, however, that such a solution could lead to undesirable practices, such as the sale of the information by an unsuccessful contractor or supplier to a successful one. The Working Group requested the Secretariat to present those various possible approaches as alternatives in the next draft of the Model Law.

156. It was agreed that paragraph (5) should be reformulated so as to clarify and amplify the distinction between "grounds" for the denial of prequalification and "reasons to substantiate those grounds".

Paragraph (6)

157. It was noted that the issue addressed in paragraph (6) was also addressed in article 28(8 *bis*). However, paragraph (6), which referred to "re-evaluating" the qualifications of "contractors and suppliers that have been prequalified", was inconsistent with article 28(8 *bis*), which referred only to the contractor or supplier submitting the most economic tender and under which that contractor or supplier would be required "to reconfirm" its qualifications.

158. It was proposed that paragraph (6) should be deleted, as its purpose was more satisfactorily achieved by article 28(8 *bis*), particularly in view of the stipulation in article 28(8 *bis*) that the criteria to be used for the reconfirmation had to be the same as those used in the prequalification proceedings.

159. It was stated, however, that article 28(8 *bis*) was unclear as to whether the contractor or supplier would merely have to update information previously submitted with respect to its qualifications, or whether its qualifications would be completely re-evaluated. In addition, a view was expressed that, when prequalification proceedings were used, article 28(8 *bis*) should merely give the procuring entity the right to require the successful tender to reconfirm its qualifications; the procuring entity should not be obliged to do so, as was presently the case under article 28(8 *bis*). It was noted that, if the Model Law were to provide for prequalification proceedings in connection with methods of procurement in addition to tendering, the provisions concerning the reconfirmation of qualifications would have to be made applicable to those other methods as well.

160. It was said that paragraph (6) might have some utility if it were reformulated so as to give the procuring entity the right to revise its decision that a contractor or supplier was qualified if it subsequently appeared that the contractor or supplier was not qualified.

161. The prevailing view was that paragraph (6) was unacceptable in its present form. The Working Group decided to defer its decision on the necessity for the paragraph or its formulation of the paragraph until its consideration of article 28(8 *bis*).

Article 17

Provision of solicitation documents to contractors and suppliers

162. The Working Group found article 17 to be generally acceptable.

Article 18

Contents of solicitation documents

163. The discussion and decision of the Working Group on the subject of cross-references in connection with article 16, reflected in this report in paragraph 137, above, also applied in respect of article 18.

164. The Working Group decided to change the word "all", appearing within square brackets in the *chapeau*, to "the". A proposal that the final words of the *chapeau*, "including, but not limited to, the following information", should be changed to "namely", was not adopted, as that change was said to reduce the scope of the information required by the *chapeau*. It was decided that the words within square brackets, "and information concerning the procedures for the opening, examination, comparison and evaluation of tenders", should be retained.

165. The Working Group found subparagraphs (a), (i), (k), (m), (o), (q), (r) and (t) to be generally acceptable.

166. In subparagraph (b), in the reference to criteria for "the evaluation of the qualifications of contractors and suppliers or relative to the reconfirmation of qualifications", the Working Group decided to replace the word "or" with the word "and" in order to make clear that the criteria set out in article 8 are to govern evaluation of qualifications at any stage of the procurement proceedings.

167. The Working Group decided to delete the words within square brackets in subparagraph (d), since they were not needed in view of the change to article 10 that had been agreed upon by the Working Group.

168. In connection with subparagraph (e), it was agreed that the cross-reference to article 20 should be relocated so as to more clearly relate to "technical and quality characteristics".

169. A proposal was made that, in the opening words of subparagraph (f), the word "required" in reference to the

terms and conditions of the procurement contract should be changed to "mandatory". The word "mandatory" was said to have a more precise meaning than "required". According to another view, however, the use of words such as "required" or "mandatory" gave rise to unintended and undesirable implications, e.g., that some terms or conditions of the contract might not be mandatory, or that certain aspects of tenders could be subject to negotiations.

170. A further view was that subparagraph (f) should require the tender solicitation documents to contain all the terms and conditions of the contract. In addition, it was proposed that the documents should contain a form of the contract that was to be signed by the successful tenderer. In response, it was observed that the successful tenderer would not necessarily be called upon to sign a written procurement contract; in some cases, the contract might be formed simply by the notification to the tenderer that its tender had been accepted. In that connection, a proposal was made to change the words "of the procurement contract" to "of any procurement contract". It was also stated that it should not be necessary for the tender solicitation documents to contain all of the contractual terms and conditions, since the procuring entity might not be in a position to finalize certain terms and conditions (i.e., those not relating to the essence of the contract) when the tender solicitation documents were issued. It was suggested that subparagraph (f) require the documents to contain the "essential" contractual terms and conditions. In response to that suggestion, however, it was stated that it was difficult to distinguish between essential and non-essential terms and conditions.

171. In the light of the foregoing discussion, the Working Group decided to omit any characterization of the contractual terms and conditions to be included in the tender solicitation documents, and to avoid an implication that a contract document must be signed in all cases, by changing the opening words of subparagraph (f) to refer to "the terms and conditions of the procurement contract and the contract form, if any, to be signed by the parties".

172. Views were expressed in favour of retaining the material within square brackets in subparagraph (f). According to that view, it was important to maintain the reference to the allocation between the parties of the risk of higher costs of performing the contract. Retention of the reference was said to be important in view of the deletion by the Working Group, at its eleventh session, of article 21, which dealt with the same subject. In opposition, it was stated that retention of the reference would be inconsistent with the decision to delete article 21. A further view was that the references to certain additional terms and conditions, such as the means of settling disputes, were useful and should be retained.

173. The decision of the Working Group was that the material within square brackets in subparagraph (f) should be deleted in its entirety, since the choice of examples of types of contractual terms and conditions to be mentioned was arbitrary and, in any event, the examples mentioned were already covered by the opening words of the subparagraph.

174. It was agreed that the word "solicited" in subparagraph (g) should be changed to "permitted", in view of the decision by the Working Group at its eleventh session that the Model Law should not deal with the solicitation of alternative tenders.

175. It was agreed that the word "designation" in subparagraph (h) should be changed to "description".

176. In connection with subparagraph (k), a suggestion was made that article 12(1) should be divided into two subparagraphs in order to differentiate in a clear manner the rule of general application, contained in the first sentence, from the rule applicable only in the case of international tendering proceedings, contained in the remainder of the paragraph.

177. The Working Group decided to delete the words at the end of the first sentence of subparagraph (l), relating to any choice offered by the procuring entity with respect to the tender security, since that subject-matter was covered by the preceding wording of the subparagraph. It was also agreed that subparagraph (l) should include references to any other types of security, such as securities for the performance of the contract and other securities such as labour and materials bonds, that the procuring entity required.

178. It was agreed that the reference in subparagraph (n) to the time and place of a meeting of contractors and suppliers should be reformulated so as to require the procuring entity to stipulate in the tender solicitation documents only whether or not it planned to hold such a meeting. It was noted that the time and place might not be known when the tender solicitation documents were prepared.

179. The Working Group agreed to consider subparagraph (n bis) when it considered article 22(2) (see paragraph 199 below).

180. It was agreed that subparagraph (p) should terminate immediately after the reference to article 28(7)(c). The material following that reference was found to be unnecessary, as its subject matter was already covered by the preceding wording of the subparagraph. Including that material was said to present the danger of inconsistency with article 28. A proposed addition to the subparagraph, that the tender documents should state how solicited and unsolicited alternative tenders would be treated, was not adopted, since that issue was covered by the portion of the subparagraph that the Working Group had decided to retain.

181. Objections were raised to subparagraph (s) in its entirety. The subparagraph was said to put too onerous a burden on the procuring entity to identify the laws referred to in the subparagraph. It was noted that laws pertinent to the performance of the procurement contract, in particular, were potentially wide-ranging, and the procuring entity might not be aware of all of them. A particular problem was noted in the case of States with federal systems, where it was sometimes difficult to ascertain whether the national law or the law of subdivisions of the federation

applied. It was also stated that contractors and suppliers should be expected to obtain their own competent professional legal advice with respect to the relevant laws. Furthermore, subparagraph (ii) was said to be outside the proper ambit of the Model Law, as it dealt with laws pertinent to the performance of the procurement contract, rather than to the tendering proceedings. A view was expressed that subparagraph (s) in its present form should be replaced by the formulation used in article 16(3 *bis*).

182. According to an opposing view, it was reasonable to expect the procuring entity to be aware at least of the laws and regulations pertinent to the procurement proceedings in which it was engaging. The information required by subparagraph (s)(i) was said to be useful to contractors and suppliers and it was stated that the provision should be retained, subject to the removal of the reference to "other laws and regulations . . . directly pertinent to the tendering proceedings" and the relocation of that reference to subparagraph (s)(ii). Subparagraph (s)(ii) was also said to be useful, and a proposal was made to retain that provision, subject to deletion of the words "of itself" so that an omission of a law or regulation referred to in the provision would not constitute grounds for review under any circumstances. A further proposal was to retain subparagraph (s)(i) subject to deletion of the word "all" from the phrase "all other laws and regulations", but to delete subparagraph (s)(ii).

183. The decision of the Working Group was to retain subparagraph (s)(i), to delete the word "all", to add a proviso to the effect that "the omission of any such reference shall not constitute grounds for review under article 36 or give rise to liability on the part of the procuring entity", and to delete subparagraph (s)(ii).

184. It was agreed that, instead of referring only to countertrade commitments, subparagraph (u) should refer to all commitments to be made by the contracts or supplier outside the contract, such as commitments relating to countertrade and to the transfer of technology. It was said to be important for contractors and suppliers to be aware that such commitments would be required, as they could alter the balance of the commercial relationship between the parties.

185. It was agreed that subparagraph (v) should be deleted, as the subject-matter of the subparagraph was sufficiently addressed in the Model Law itself and required no further elaboration in the tender solicitation documents.

186. A view was expressed that the information required by subparagraph (w) was of fundamental importance to contractors and suppliers and that the subparagraph should be retained. In opposition, it was stated that the subject-matter of the subparagraph was already covered by subparagraph (s). Another view was that the right of review would be dealt with in the section of the Model Law dealing with review, and that it was unnecessary for the right to be mentioned in the tender solicitation documents. The Working Group decided to defer its decision with respect to the subparagraph until it discussed the section on review.

187. The Working Group decided to retain subparagraph (x), on the grounds that it was important for tenderers to know that the procuring entity had the right to reject all tenders.

188. With respect to subparagraph (y), the Working Group agreed that it was important for a tenderer to know what formalities would be required for the contract to enter into force. It was also agreed that the commentary should mention what formalities were envisaged by this subparagraph, including such formalities, where applicable, as the signing of a contract document and approval of the contract by a supervisory body.

Article 19

Charge for solicitation documents

189. A view was expressed that it would be preferable for article 19 to provide that the charge for the tender solicitation documents must "not exceed" the cost of printing the documents and providing them to contractors and suppliers, rather than, as in the present draft, that the charge "shall reflect only" that cost. In support of the present wording, it was observed that accounting practices for determining such costs were not uniform and differed among States, and that it was not practicable to require the procuring entity to calculate the costs precisely. The Working Group decided to retain the article in its present form.

Article 20

Rules concerning description of goods or construction in prequalification documents; language of prequalification documents and solicitation documents

190. A view was expressed that the present title was too lengthy and that the title of the article in the first draft (A/CN.9/WG.V/WP.24), which read, "Rules concerning formulation of prequalification documents and procurement documents", was preferable. The Working Group decided to retain the present title.

191. The Working Group decided to delete the word "unnecessary", which appeared within square brackets in paragraph (1), as it was said that the word contained a subjective element and that its use could lead to disputes as to whether or not obstacles to participation were "necessary".

192. A proposal was made to delete the word "objective", used in paragraph (2) in reference to technical and quality characteristics of the goods or construction to be procured. Its meaning was said to be uncertain. It was also said that the word was not needed since technical and quality characteristics were inherently objective. Various proposals were made with a view towards expressing more satisfactorily the intent of the word "objective" in the context of paragraph (2), namely, to prevent the use of subjective terms in describing the technical and quality characteristics of the goods or construction. After

discussion, the Working Group decided to retain the word "objective".

193. The Working Group found subparagraphs (a) and (b) of paragraph (3) to be generally acceptable. It was noted that, at its eleventh session, the Working Group had decided to delete the rule that had appeared in article 20(3)(c) of the first draft to the effect that, in international procurement proceedings, international standards should be used, where available, in the formulation of the prequalification documents and the tender solicitation documents. A view was expressed that the rule should be reintroduced into paragraph (3), since the use of national standards by the procuring entity might create difficulties for foreign contractors and suppliers, who might be unfamiliar with those standards or who might not be able to comply with them. There was insufficient support in the Working Group for revising its previous decision to delete the preference for the use of international standards.

194. It was agreed that the final sentence of paragraph (4), which appeared within parentheses and read, "In the event of a variation or conflict between language versions, the version in the language customarily used in international trade shall prevail", should be deleted. It was said that a State enacting the Model Law would be unlikely to agree to a provision according to which another language was to prevail over its own official language. It was also agreed that the commentary should discuss the problems and issues arising from conflicts between different language versions of the prequalification documents and the tender solicitation documents. It was further agreed that the commentary should suggest that the different language versions of the tender solicitation documents should be issued separately, as the issuance of tender solicitation documents in bilingual versions was reported to cause difficulties in practice.

Article 22

Clarifications and modifications of solicitation documents

Paragraph (1)

195. A proposal was made to delete the word "promptly". Instead, the second sentence of paragraph (1) should specify a period of time prior to the deadline for submission of tenders by which the procuring entity must respond to a request for clarification of the tender solicitation documents. In response, it was said to be impossible to stipulate a specific period of time that would be appropriate in all cases of procurement and for conditions in all regions of the world. The Working Group agreed that the sentence should be reformulated so as to accord with the decision taken by the Working Group in connection with article 16(3 *bis*) (see paragraph 151 above).

196. With respect to the final sentence of paragraph (1), a view was expressed that the response by the procuring entity to a request for clarification of the tender solicitation documents should have to be communicated to all contractors and suppliers that were provided with the tender solicitation documents only if the response affected

all such contractors and suppliers, and not just the contractor or supplier that made the request. In response, it was said that the sentence as presently formulated ensured equal treatment of all contractors and suppliers, and avoided the necessity for the procuring entity to make a judgment as to whether or not a response to a request for clarification had general applicability.

Paragraph (2)

197. In connection with paragraph (2), the Working Group engaged in a discussion concerning the right of the procuring entity to modify the tender solicitation documents. Views were expressed that some limits should be imposed on that right in order to protect contractors and suppliers that had invested considerable amounts of time and money in preparing their tenders. One proposal was that the procuring entity should not be able to make "substantive" modifications to the tender solicitation documents. Another proposal was that the procuring entity should be permitted to modify the documents only "within a reasonable time", with the intent that modifications would not be permitted at a late stage in the preparation of tenders. It was also proposed that remedies, such as compensation, should be provided to contractors and suppliers who suffered loss as a result of the modifications if the modifications were occasioned by factors attributable solely to the procuring entity. It was said that such a provision would provide greater balance with respect to the rights of the parties.

198. The prevailing view was that the right of the procuring entity to modify the tender solicitation documents should not be restricted in the Model Law. It was accordingly decided that the words in paragraph (2), "provided that the right to do so has been specified in the solicitation documents", and the companion provision in article 18(*n bis*), should be deleted. In support of that view, it was stated that the right of the procuring entity to modify the tender solicitation documents was fundamental and necessary in order to enable the procuring entity to obtain goods or construction that met its needs. That right should not be restricted to non-substantive modifications. It was also agreed, however, that contractors and suppliers should be given reasonable notice of the modifications and an opportunity to take the modifications into account in their tenders. The possibility that the tender solicitation documents might be modified was said to be a normal commercial risk that was generally accepted by contractors and suppliers as a normal part of doing business. It was observed that, under articles 25(3) and 26(2)(*d*), contractors and suppliers could withdraw their tenders without forfeiting their tender securities if they did not wish to accommodate their tenders to modifications in the tender solicitation documents. It was also pointed out that, if the procuring entity encountered a need to modify the tender solicitation document but was unable to do so under the Model Law, its only other possible course of action would be to reject all tenders and recommence procurement proceedings, which would work a greater hardship on contractors and suppliers than modification of the documents. The Working Group also agreed, however, that the commentary advise the procuring entity to try to avoid modifying the documents.

199. A proposal was made to reformulate article 18(*n bis*) in such a manner that the statement to be included in the tender solicitation documents concerning the right of the procuring entity to modify those documents would merely constitute information given to contractors and suppliers, and that inclusion of the statement would not be a condition to the exercise of that right. The proposal was not adopted. It was said that such a formulation could be misinterpreted to mean that inclusion of the statement would be a condition to the exercise of the right to modify the documents. In addition, specification in the tender solicitation documents of the right of the procuring entity to modify the documents was encompassed by an earlier decision of the Working Group that matters adequately dealt with in the Model Law itself need not be reflected in the tender solicitation documents.

Paragraph (3)

200. A view was expressed that the words contained within square brackets in paragraph (3) could give the erroneous impression that, when a procuring entity responded by telephone to a request for clarification from a contractor or supplier, a written confirmation of the response was to be given only to the contractor or supplier that made the request. It was agreed that the paragraph should be reformulated so as to clarify that the written confirmation must be given to all contractors and suppliers to which the procuring entity sent the tender solicitation documents. A view was expressed that paragraph (3) might be merged with paragraph (1).

Paragraph (4)

201. The Working Group found paragraph (4) to be generally acceptable.

Article 23 Language of tenders

202. It was stated that the present formulation of article 23 was ambiguous as to whether or not the procuring entity could permit tenders to be submitted in languages other than those in which the tender solicitation documents had been issued. In order to remedy that ambiguity, it was agreed that the words "or in any other language which the procuring entity specifies in the tender solicitation documents" should be added at the end of the article.

Article 24 Submission of tenders

Paragraphs (1) and (2)

203. A view was expressed that the portion of paragraph (1) making particular reference to foreign contractors and suppliers should be deleted, in order to avoid an impression that those contractors and suppliers should receive special treatment. In conformity with that view, the Working Group decided to reformulate the second sentence of the paragraph so as to read along the following lines: "The deadline shall allow sufficient time for all

interested contractors and suppliers to prepare and submit their tenders." It was further agreed that the deleted portion of the sentence, making special reference to foreign contractors and suppliers, should not be added to the commentary.

204. The Working Group found paragraph (2) to be generally acceptable.

Paragraph (2 bis)

205. A view was expressed that the words "unforeseen circumstances" were ambiguous in that it was uncertain whether foreseeability was to be ascertained according to an objective or a subjective standard. It was accordingly agreed that the words should be replaced by a reference to circumstances beyond the control of contractors and suppliers. It was also agreed that the commentary should explain that, under the paragraph as thus amended, the determination as to the existence of circumstance beyond the control of contractors and suppliers, and the decision to extend the deadline for submission of tenders, rested with the procuring entity.

Paragraph (2 ter)

206. It was agreed that the final sentence of paragraph (2 *ter*), contained within square brackets, should be reformulated so as to clarify that any notice of extension of the deadline for submission of tenders given by telephone had to be given by telephone to all contractors and suppliers to which the procuring entity had provided the tender solicitation documents. To that end, it was agreed to add, after the words "provided that", words along the following lines: "such telephone notice is given to all such contractors and suppliers and provided that . . .". It was agreed that the same addition should be made in other provisions of the Model Law containing the same wording in reference to notices or other communications by telephone.

Paragraphs (3) and (4)

207. It was agreed that the second sentence of paragraph (4), contained within square brackets, should be deleted, since the submission of tenders by means other than in writing and in sealed envelopes would be inconsistent with the principle that tenders must remain secret until their opening. In consequence of that decision, it was agreed that the words "or considered" in paragraph (3) were no longer necessary and should be deleted.

Article 25 Period effectiveness of tenders; modification and withdrawal of tenders

Paragraph (1)

208. The Working Group found paragraph (1) to be generally acceptable.

Paragraph (2)

209. In connection with subparagraph (*a*), the Working Group decided to delete the words "in exceptional

circumstances", since they created a potential for disputes. It was agreed that the final sentence of the subparagraph, contained within square brackets, should be retained, subject to alignment with changes made by the Working Group to the same wording used in other provisions of the Model Law (see, e.g., paragraph 206 above).

210. With respect to subparagraph (b), it was generally agreed that, for the protection of the procuring entity, a contractor or supplier that agreed to an extension of the period of validity of its tender should also be required to extend its tender security. However, making it mandatory for the procuring entity to require such contractors and suppliers to extend their tender securities was found to be unsatisfactory. It was said to be inconsistent with the general tenor of the Model Law, which was directed mainly to the relationship between the procuring entity and contractors and suppliers to it. The obligation imposed on the procuring entity by the subparagraph as presently formulated was not directed at that relationship. It was accordingly agreed that the subparagraph should be reformulated so as to provide that a contractor or supplier that agreed to extend the period of validity of its tender should also extend the validity of its tender security.

Paragraph (3)

211. A view was expressed that modifications of tenders should have to be submitted in writing and in sealed envelopes.

212. A drafting suggestion was made that all provisions in the Model Law using similar wording concerning the form in which notices or other information was to be communicated should be consolidated into a single provision so as to avoid duplication.

213. It was agreed that paragraph (3) should be retained, but that the words "but not thereafter" should be inserted after the words "deadline for the submission of tenders", appearing towards the beginning of the paragraph, in order to clarify that a tender may not be modified or withdrawn after the deadline.

Article 26 Tender securities

Paragraph (1)

214. The Working Group found subparagraph (a) to be generally acceptable.

215. Subparagraph (b) was found to be unsatisfactory in its present form. The drafting of the subparagraph was found to be difficult to understand, and the meaning of certain terms, such as "foreign institution or entity", was said to be unclear. With respect to the substance of the paragraph, it was observed that many States had laws governing various aspects of securities and guarantees of the nature dealt with in article 26. It was said that the acceptability of the Model Law to States would be prejudiced if the subparagraph required a procuring entity to accept a tender security that it would not otherwise be

permitted to accept under the law of that State, or if the subparagraph were otherwise inconsistent with that law.

216. It was stated that subparagraph (b), which restricted the ability of the procuring entity to reject a tender security on the ground that it was issued by a foreign institution, seemed inconsistent with the principle, presently contained in subparagraph (c), that the tender security should be from an institution that was acceptable to the procuring entity. That principle was said to be important in order to enable the procuring entity, for example, to reject a tender security from an institution that was not creditworthy.

217. According to another view, subparagraph (b) served no useful purpose as, in essence, it did little more than provide that the tender security must conform with the law of the State of the procuring entity. In response, it was noted that underlying the subparagraph was the principle of non-discrimination against foreign contractors and suppliers with respect to tender securities. When subparagraph (b) was considered in connection with subparagraph (c), the general principle emerged that, subject to there being no discrimination against foreign contractors and suppliers, the tender security must be acceptable to the procuring entity. The Working Group agreed with that general principle and requested the Secretariat to find a means to express it in a more satisfactory manner, either in two subparagraphs, as in the current draft, or in a single paragraph. For the possibility of expressing it in a single paragraph, wording along the following lines was proposed:

"In international tendering proceedings, a contractor or supplier shall not be precluded from providing a tender security issued by a foreign institution or entity from which such security is acceptable to the procuring entity, unless the issuance of the security would be in violation of a law of (this State) relating to the issuance of securities of the type in question."

218. After the foregoing discussion, the Working Group examined subparagraph (c) in greater detail. It was noted that, in some countries, a tender security issued by a foreign institution must be confirmed by a local institution. The Working Group agreed to a proposal that wording should be added to the effect that not only the institution or entity issuing the tender security, but also the confirming institution or entity, if any, must be acceptable to the procuring entity.

219. According to another view, however, the Model Law should not encourage the requirement of confirmation by a local institution of a foreign tender security. It was said that such a requirement could constitute an obstacle to the participation by foreign contractors and suppliers in tendering proceedings, since they could have difficulty in obtaining the confirmation in time for the submission of tenders. It was also pointed out that the requirement of a confirmation could add to the tender prices of foreign tenderers a cost that did not have to be incurred by local tenderers. It was said that, as long as the foreign institution was creditworthy and otherwise acceptable to the procuring entity, local confirmation of the

tender security should not be required. The Working Group agreed that the problems of requiring local confirmation of a tender security issued by a foreign institution should be discussed in the commentary.

220. It was noted that, with the use of the word "shall" in the *chapeau* of subparagraph (d), the subparagraph in effect provided that, if the procuring entity required a tender security, it must require that the security contain the terms stipulated in the subparagraph. That approach was regarded by the Working Group as inappropriate. It therefore agreed that the word "shall" should be changed to "may". In order to avoid an implication that the procuring entity could not require the tender security to contain terms other than those stipulated in the subparagraph, it was agreed that words should be inserted at the beginning of the *chapeau* along the following lines: "Without limiting its right to stipulate other circumstances under which it shall be entitled to claim the amount of the tender security".

221. It was agreed that subparagraph (d)(i) should be clarified by reformulating it along the following lines: "withdraws or modifies its tender after the deadline for submission of tenders." It was agreed that subparagraph (d)(ii) should be deleted, as forfeiture of the tender security was regarded as too harsh a consequence for a refusal to accept a correction of an arithmetical error. The rejection of the tender on that ground pursuant to article 28(2)(b) was regarded as sufficient. It was also stated in that connection that whether or not a correction was "arithmetical" was sometimes questionable.

222. The Working Group found subparagraph (d)(iii) to be generally acceptable.

Paragraph (2)

223. The Working Group found paragraph (2) to be generally acceptable, subject to the redrafting of subparagraph (d) to read along the following lines: "the withdrawal of the tender in connection with which the tender security was supplied prior to the deadline for the submission of tenders".

Article 27 Opening of tenders

Paragraph (1)

224. The Working Group found paragraph (1) to be generally acceptable.

Paragraph (2)

225. It was generally agreed that the right under paragraph (2) of tenderers or their representatives to be present at the opening of tenders should not apply in cases of national security or national defence. It was noted that, although those cases were excluded from the scope of application of the Model Law by article 1, a procuring entity would nevertheless have the option to apply the Model Law in such cases (see paragraph 14 above). The exception to the right of contractors and suppliers or their

representatives to be present at the opening of tenders was said to be needed for procurement proceedings in which the procuring entity exercised that option. A proposal was also made that the Model Law should deal with questions of procurement involving national security and national defence in a separate omnibus provision, rather than in individual articles. The Secretariat was requested to consider those proposals in redrafting the Model Law.

226. A view was expressed that the concepts of "national security" and "national defence" should not be introduced into the Model Law, since they were given different meanings and content in different countries, and sometimes led to disagreement (see also paragraph 13 above).

227. It was noted that the Model Law could not deal with the problem of the inability of a contractor or supplier to attend the opening of tenders due to the denial of a visa or other action over which the procuring entity had no control. In that connection, it was agreed that the paragraph should be reformulated so as to specify that the contractors and suppliers or their representatives should be permitted "by the procuring entity" to be present at the opening of tenders.

Paragraph (3)

228. The requirement in paragraph (3) that the procuring entity had to communicate the names and addresses of tenderers and their tender prices to all contractors or suppliers who were not present or represented at the opening of tenders was found to impose too heavy a burden on the procuring entity and to be contrary to practice. It was noted, however, that some contractors or suppliers might not be able to attend for various legitimate reasons. It was agreed, therefore, that the procuring entity should be required to communicate that information on request to tenderers who were not present or represented at the opening. In addition, the Working Group agreed that the words contained within square brackets, "and recorded immediately in the records of the tendering proceedings required by article 33", should be retained, subject to changing the reference to read "article 33(1)".

II. FUTURE WORK AND OTHER BUSINESS

229. The Working Group decided that at its next session it would complete its consideration of the draft articles of the Model Law set forth in A/CN.9/WG.V/WP.28 by taking up articles 28 through 35, and would consider A/CN.9/WG.V/WP.27, dealing with the review of acts and decisions of, and procedures followed by, the procuring entity. For the next session of the Working Group, the Secretariat was requested to revise articles 1 through 27 of the Model Law to take into account the discussions and decisions concerning those articles at the current session. The Working Group noted that, according to the decision of the Commission at its twenty-third session (A/45/17, para. 79), the thirteenth session of the Working Group would be held from 15 to 26 July 1991 in New York and the fourteenth session would be held from 2 to 13 December 1991 at Vienna.

B. Working papers submitted to the Working Group on the New International Economic Order at its twelfth session

1. Procurement: review of acts and decisions of, and procedures followed by, the procuring entity under the Model Law on Procurement: report of the Secretary-General (A/CN.9/WG.V/WP.27) [Original: English]

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REVIEW OF ACTS AND DECISIONS OF, AND PROCEDURES FOLLOWED BY, THE PROCURING ENTITY UNDER THE MODEL LAW ON PROCUREMENT

1. The present document has been prepared pursuant to the request of the Working Group at its eleventh session (5-16 February 1990) that the Secretariat prepare for the twelfth session of the Working Group draft provisions dealing with review of acts and decisions of, and procedures followed by, the procuring entity (A/CN.9/331, para. 222). (Those acts, decisions and procedures are hereinafter collectively referred to as "acts".)

2. There exist in most States mechanisms and procedures for review of acts of administrative organs and other public entities. In some States, review mechanisms and procedures have been established specifically for disputes arising in the context of procurement by those organs and entities. In other States, those disputes are dealt with by means of the general mechanisms and procedures for review of administrative acts.

3. Certain important aspects of proceedings for review, such as the forum where review may be sought and the remedies that may be granted, are related to fundamental conceptual and structural aspects of the legal system and system of State administration in every country. Many

legal systems provide for review of acts of administrative organs and other public entities before an administrative body that exercises hierarchical authority or control over the organ or entity (hereinafter referred to as "hierarchical administrative review"). Hierarchical administrative review is not, however, a feature of other legal systems. In legal systems that provide for hierarchical administrative review, the question of which body or bodies are to exercise that function in respect of acts of particular organs or entities depends largely on the structure of the State administration. In the context of procurement, for example, some States provide for review by a body that exercises overall supervision and control over procurement in the State (e.g., a central tender board); in other States the review function is performed by the body that exercises financial control and oversight over operations of the Government and of the public administration. Some States provide for review by the head of State in certain cases.

4. In some States, the review function in respect of particular types of cases involving administrative organs or other public entities is performed by specialized independent administrative bodies whose competence is sometimes referred to as "quasi-judicial". Those bodies are not, however, considered to be courts within the judicial system.

5. Many legal systems provide for judicial review of acts of administrative organs and public entities. In several of

those legal systems judicial review is provided in addition to administrative review, while in other systems only judicial review is provided. Some legal systems provide only administrative review, and not judicial review. In some legal systems where both administrative and judicial review is provided, judicial review may be sought only after opportunities for administrative review have been exhausted; in other systems the two means of review are available as options.

6. In some legal systems that provide for judicial review there are considerable differences as to the nature of the courts that are competent to review acts of administrative organs and public entities. In some countries, a separate system of administrative courts exists to review those acts. In other countries, competence to review those acts is vested in courts within a unified court system. In some of the latter countries the courts are courts of general jurisdiction, while in others the courts constitute a separate division of a unified court system. In yet other countries, competence to review acts of administrative organs and public entities is divided between administrative courts and civil courts.

7. The types of remedies that may be granted for unlawful acts of an administrative organ or public entity vary among legal systems. Remedies that may be granted by hierarchical administrative bodies in many legal systems include annulling or revising the act that is the subject of the complaint. In other legal systems the administrative body cannot annul or revise the act, but it can grant other types of remedies.

8. The nature of judicial remedies that may be granted by courts is in many legal systems linked to the nature of the legal action commenced in the court or to the competence of the court. In some systems, for example, in one category of legal action the court may only annul the act complained of and may not, for example, revise the act or award damages; in another category of legal action, however, damages and other types of remedies may be awarded. In other legal systems, a court may be competent to annul or revise acts found to be unlawful, but not be competent to order an administrative organ or public entity to act lawfully or to enjoin it from acting unlawfully. In addition, the grounds on which courts may grant particular types of remedies differ among legal systems, and depend upon the substantive law in each system.

9. The fact that proceedings for review of procurement actions, decisions and procedures involve fundamental conceptual and structural aspects of legal systems and systems of State administration, and the wide diversity among countries with respect to those aspects, make it difficult to formulate provisions on mechanisms and procedures for review designed for universal application. Any such provisions would have to avoid impinging upon those fundamental aspects, since it is unrealistic to expect countries to adopt provisions that conflict with those fundamental aspects or to adapt their legal or administrative systems to accommodate the Model Law. Accordingly, the provisions have to be more skeletal and contain more variants than in the case of uniform legislation in

areas that do not present the difficulties mentioned above and in respect of which a greater degree of harmonization or unification is possible.

10. In light of the foregoing considerations, the Secretariat suggests for consideration by the Working Group three possible approaches to the treatment of the question of review proceedings. The first possible approach is to prepare provisions intended to be adopted by an implementing State as an integral part of the Model Law on Procurement. Although the provisions would have to be skeletal, such an approach would not necessarily be unusual or undesirable. Several existing national procurement laws examined by the Secretariat treat the question of review in a very basic manner and leave the details of the substantive and procedural aspects of the review proceedings to be governed by other laws, regulations or practices in the country. Some national procurement laws do no more than vest a particular administrative organ with competence over disputes concerning irregularities in procurement proceedings. Pursuant to the first approach, the Secretariat has prepared and set forth in annex I to the present document draft provisions on review that might be included in the Model Law on Procurement, together with a commentary on those provisions.

11. The second possible approach is to prepare provisions dealing with review, but to intend those provisions to have a function different from that of the main body of the Model Law on Procurement. The main body of the Model Law would provide a comprehensive uniform legal framework for procurement proceedings (subject to supplementation by procurement regulations in the implementing State). An implementing State would be expected to enact it without change or with only such minimal changes as were necessary to meet particular important needs in the implementing State. The provisions on review, by contrast, would be intended to serve as guidance to implementing States in evaluating the sufficiency and effectiveness of their mechanisms and procedures for review of procurement actions, decisions and procedures. The provisions would contain all of the elements considered by the Commission to be essential components of a sufficient and effective means of review. Further, the provisions could provide some legislative guidance to States that found that their review mechanisms and procedures lacked certain essential elements. Provisions along the lines set forth in annex I to the present document, with or without an accompanying commentary, might be regarded as serving such a function. In adopting the Model Law on Procurement, the Commission could clearly express its differing intentions with respect to the main body of the Model Law and the provisions on review, and strongly encourage implementing States to ensure the sufficiency and effectiveness of their review mechanisms and procedures using the review provisions in the Model Law as a guide.

12. Under the third possible approach, the Model Law on Procurement would not contain provisions of a legislative nature on review. Rather, the adoption of the Model Law by the Commission would be accompanied by an expression by the Commission of the necessity for an effective means of review, and set forth, in the form

of a recommendation to States, the elements that it considered essential. A possible formulation for such a recommendation has been set forth in annex II to the present document.

13. The formulation set forth in annex II is modelled after a Directive adopted by the Council of the European Communities (EC) dealing with review in cases covered by EC Directives on the award of public supply contracts and public works contracts (Council Directive of 21 December 1989 on the Co-ordination of the Laws, Regulations and Administrative Provisions relating to the Application of Review Procedures to the Award of Public Supply and Public Works Contracts (89/665/EEC), herein-after referred to as the "EC review Directive"). Member States of the EC must implement the Directive in their respective legal systems by 1 December 1991 (article 5 of the EC review Directive).

14. If either the second approach (paragraph 11 above) or the third approach (paragraph 12 above) is adopted, the Commission may wish to consider, at an appropriate time, whether it should prepare comprehensive review provisions tailored to different legal systems. That might involve, for example, the preparation of several sets of provisions, each set adapted to the particular circumstances of one of the principal types of legal systems in the world. Or, it might involve providing technical assistance, upon request, directly to a State to aid it to prepare review provisions tailored to the individualized circumstances of that State. The Commission might also wish to consider possible means of providing technical assistance to requesting States in elaborating procurement regulations to supplement the Model Law on Procurement. The Secretariat raises the foregoing possibilities without necessarily expecting the Working Group to act on them at the present time.

ANNEX I

DRAFT PROVISIONS ON REVIEW FOR MODEL LAW ON PROCUREMENT

Chapter IV. Review

Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 214-218; A/CN.9/315, para. 114. The commentary contains notes within square brackets, designated as "Working Group notes", that are intended for the information and guidance of the Working Group in considering the draft provisions. They would not appear in the final version of the commentary to the Model Law.]

An effective means to review acts and decisions of the procuring entity and procedures followed by the procuring entity is essential to guard against misapplication of the Model Law on Procurement or of the procurement regulations, to ensure the proper functioning of the procurement system and to promote confidence in that system. This chapter sets forth provisions establishing a right of review and setting forth provisions governing its exercise. In order to enable the provisions to be accommodated within the widely differing conceptual and structural frameworks of legal systems throughout the world, only basic features of the right of review and its exercise are dealt with. Procurement regulations to be formulated by an implementing State might include more detailed rules concerning matters that are not dealt with by the Model Law on Procurement or by other legal rules in the State. In some cases, alternative approaches to the treatment of particular issues have been formulated and placed within square brackets; an implementing State should choose the formulation that it regards as the most appropriate.

* * *

Article 36. Right to review

Any natural or juridical person, regardless of nationality, who has an interest in obtaining a procurement contract

resulting or anticipated to result from procurement proceedings covered by this Law and who claims to suffer, to risk suffering or to have suffered detriment due to an unlawful act or decision of, or procedure followed by, the procuring entity in relation to those procurement proceedings may seek review of the act, decision or procedure in accordance with articles 37 through [42] at any stage of the procurement proceedings or after the procurement proceedings have terminated.

* * *

Commentary

1. Under this article, review may be sought by a person "who has an interest in obtaining a procurement contract . . . and who claims to suffer, to risk suffering or to have suffered detriment". The right to seek review thus appertains not only to contractors and suppliers participating in procurement proceedings, but also to persons who have not participated, such as contractors and suppliers who have been unlawfully precluded from participating in procurement proceedings. The article does not deal with the nature or degree of interest or detriment that is required for the person to be able to seek review, or with other issues relating to the capacity of the person to seek review. Those issues are left to be resolved in accordance with the relevant legal rules in each implementing State.

[Working Group note: one such issue to be left to other rules in each implementing State may be whether the right to review is restricted to cases where particular types of provisions are alleged to have been violated. For example, in some legal systems, a distinction might be drawn between, on the one hand, requirements imposed on the procuring entity that are directed to its relationship with contractors and suppliers and that are intended to constitute legal obligations towards contractors and suppliers, and, on the other hand, other requirements that are regarded as being only "internal" to the administration, and that are not intended to constitute legal obligations of the procuring

entity towards contractors and suppliers. In those legal systems the right to review would be restricted to cases where the first type of requirement is violated by the procuring entity.]

2. An act, decision or procedure would be "unlawful" if it did not conform to the Model Law on Procurement as implemented by the State, to the procurement regulations or to another applicable legal rule.

3. Review may be sought at any stage of the procurement proceedings or after the procurement proceedings have terminated, even if the procurement contract has entered into force, subject to article 37(2) [and (3)], subject to any time limits for the submission of complaints set forth in the procurement regulations or elsewhere in the law applicable to the review proceedings and subject to any rules in the implementing State relating to prescription or to limitation of actions. [*Working Group note:* the reference to paragraph (3) of article 37 has been placed within square brackets pending a decision of the Working Group as to whether or not that paragraph should be retained.]

4. The reference to article 42 has been placed within square brackets because the article number will depend on whether or not the implementing State provides for hierarchical administrative review (see paragraph 1 of commentary to article 38).

* * *

Article 37. *Review by procuring entity or by approving authority*

(1) [Unless the procurement contract has already entered into force,] a complaint shall, in the first instance, be submitted in writing to the head of the procuring entity. However, if the complaint is based on an act or decision of, or procedure followed by, the procuring entity, and that act, decision or procedure was approved by an authority pursuant to [this Law], the complaint shall instead be submitted to the head of the authority that approved the act, decision or procedure. A reference in [this Law] to the head of the procuring entity or the head of the approving authority includes any person designated by him.

(2) The head of the procuring entity or of the approving authority shall not entertain a complaint unless it was submitted within [10] days after the earlier of the time when the person submitting it became aware of the circumstances giving rise to the complaint or the time when he should have become aware of those circumstances.

[(3) The head of the procuring entity or of the approving authority shall not entertain a complaint, or continue to entertain a complaint, after the procurement contract has entered into force.]

(4) Unless the complaint is resolved by mutual agreement of the person that submitted it and the procuring entity, the head of the procuring entity or of the approving authority shall, within [20] days after the submission of the complaint, issue a written decision. The decision shall:

(a) state the reasons for the decision; and

(b) if the complaint is upheld in whole or in part, indicate the corrective measures that are to be taken. Those measures may include the payment of compensation [for any reasonable costs incurred by the person submitting the complaint in connection with the procurement proceedings] [for loss suffered by the person submitting the complaint] as a result of an unlawful act or decision of, or procedure followed by, the procuring entity.

(5) If the head of the procuring entity or of the approving authority does not issue a decision by the time specified in paragraph (4), the person submitting the complaint or the procuring entity shall be entitled immediately thereafter to institute proceedings under article [38 or 40]. Upon the institution of such proceedings the competence of the head of the procuring entity or of the approving authority to entertain the complaint shall cease.

(6) The decision of the head of the procuring entity or of the approving authority shall be final unless proceedings are instituted under article [38 or 40].

* * *

Commentary

[*Working Group note:* sources: A/CN.9/WG.V/WP.22, para. 219; A/CN.9/315, paras. 115 and 116. With respect to the forum before which review can be sought, the Working Group agreed at its tenth session that the Model Law on Procurement should provide generally formulated alternatives from which a State could choose those that it wished to implement (A/CN.9/315, para. 116).

The opening words of paragraph (1) ("unless the procurement contract has already entered into force") and paragraph (3) have been placed within square brackets in order to invite the Working Group to consider whether those provisions should be retained. The underlying policy of those provisions is that, once the procurement contract has entered into force, there are no corrective measures that the head of the procuring entity or of the approving authority could usefully require (apart from compensation—see paragraph 3 of the commentary to the present article), unless he were to be authorized to annul the procurement contract. That may be thought to be an extraordinary power to confer on such an officer. The power to annul the contract, if it is to exist at all, may be thought to be more appropriately vested in a court, or at least in a hierarchical administrative body. The purpose of providing for first-instance review to the head of the procuring entity or of the approving authority is essentially to enable that officer to correct defective acts, decisions or procedures. Once the procurement contract has entered into force, it is too late for him to do so. If the provisions within square brackets were to be retained, hierarchical administrative review or judicial review would be available for complaints arising after the entry into force of the procurement contract.]

1. The present article provides for review to be sought in the first instance from the head of the procuring entity or of an approving authority, and subsequent articles provide for hierarchical administrative review and for judicial review. Pursuant to paragraph (1), seeking review under this article in the first instance is a prerequisite to hierarchical administrative review or judicial review.

[*Working Group note:* the period of time specified in paragraph (2) has been placed within square brackets in order to invite the Working Group to consider what period of time would be appropriate.]

2. Paragraph (4)(b) leaves it to the head of the procuring entity or of the approving authority to determine what corrective measures would be appropriate in each case (subject to any rules on that matter contained in the procurement regulations; see paragraph 5 of the commentary to the present article). Possible corrective measures may include the following: requiring the procuring entity to revise the procurement proceedings so as to be in conformity with the Model Law on Procurement, the procurement regulations or other applicable rule of law; if a

decision has been made to accept a particular tender and it is shown that another tender should be accepted, requiring the procuring entity to accept that other tender; or terminating the procurement proceedings and ordering new proceedings to be commenced.

3. Paragraph (4)(b) expressly authorizes the head of the procuring entity or of the approving authority to require the payment of compensation to the person submitting the complaint. Normally, the compensation would be payable by the procuring entity. However, where the act, decision or procedure complained of was approved by an approving authority, the head of that authority might decide that compensation should be paid by the authority.

[*Working Group note:* with respect to the types of losses in respect of which compensation may be required, two alternative possibilities are set forth within square brackets for the consideration of the Working Group. Under the first possibility, compensation may be required in respect of any reasonable costs incurred by the person submitting the complaint in connection with the procurement proceedings as a result of the unlawful act, decision or procedure. Those costs do not include profit from the procurement contract that was lost because of non-acceptance of the tender or offer of the person submitting the complaint. The types of losses that are compensable under the second possibility are broader than those under the first possibility, and might include lost profit in appropriate cases. The question as to the types of losses that should be compensable was addressed at the tenth session of the Working Group, but no decision was taken (A/CN.9/315, para. 120).]

4. An implementing State should take the following action with respect to the references within square brackets in paragraphs (5) and (6) to article "38 or 40". If the implementing State provides judicial review but not hierarchical administrative review (see paragraph 1 of commentary to article 38), the reference should be only to the article appearing in this Model Law as article 40. If the implementing State provides both forms of review but requires the person submitting the complaint to exhaust his right to hierarchical administrative review before seeking judicial review, the reference should be only to article 38. If the implementing State provides both forms of review but does not require the right to hierarchical administrative review to be exhausted before seeking judicial review, the reference should be to "article 38 or 40".

5. An implementing State may include in the procurement regulations detailed rules concerning review proceedings under this article (e.g., concerning the right of contractors and suppliers participating in the procurement proceedings, other than the one submitting the complaint, to participate in the review proceedings (see article 39); the submission of evidence; the conduct of the review proceedings; and the corrective measures that the head of the procuring entity or of the approving authority may require the procuring entity to take (see paragraphs 2 and 3 of the commentary to the present article)).

6. Review proceedings under this article should be designed to provide an expeditious disposition of the complaint. If the complaint cannot be disposed of expeditiously, the proceedings should not unduly delay the institution of proceedings for hierarchical administrative review or judicial review. To that end, paragraph (4) requires the head of the procuring entity or of the approving authority to issue a decision within [20] days after the submission of the complaint. If the decision has not been issued by the deadline, paragraph (5) permits proceedings for hierarchical administrative review or for judicial review to be instituted immediately thereafter. [*Working Group note:* the time limit is placed within square brackets in the text of paragraph (4) and in

the foregoing sentence to invite the Working Group to consider what length of time should be allowed.]

7. Certain additional rules applicable to review proceedings under this article are set forth in article 39.

* * *

Article 38. Administrative review

(1) A person may submit his complaint in writing to [insert name of administrative body]:

[(a) if his complaint cannot be submitted or entertained under article 37 because of the entry into force of the procurement contract;]

(b) pursuant to paragraph (5) of article 37; or

(c) if the person claims to be adversely affected by a decision of the head of the procuring entity or of the approving authority under article 37.

(2) The [insert name of administrative body] may grant one or more of the following remedies:

(a) declare the legal rules or principles that govern the subject-matter of the complaint;

(b) prohibit the procuring entity from acting or deciding unlawfully or from following an unlawful procedure;

(c) require the procuring entity that has acted or proceeded in an unlawful manner, or that has reached an unlawful decision, to act or to proceed in a lawful manner or to reach a lawful decision;

(d) annul in whole or in part an unlawful act or decision of the procuring entity;

(e) revise an unlawful decision by the procuring entity or substitute its own decision for such a decision;

(f) annul the procurement contract, if it has entered into force;

(g) require the payment of compensation [for any reasonable costs incurred by the person submitting the complaint in connection with the procurement proceedings] [for loss suffered by the person submitting the complaint] as a result of an unlawful act or decision of, or procedure followed by, the procuring entity;

(h) order that the procurement proceedings be terminated.

(3) The [insert name of administrative body] shall issue a written decision concerning the complaint, stating the reasons for the decision and the remedies granted, if any.

(4) The decision shall be final unless an action is commenced under article 40.

* * *

Commentary

[*Working Group note:* sources: A/CN.9/WG.V/WP.22, paras. 220, 222, 223, 226; A/CN.9/315, paras. 115, 116, 119-121; A/CN.9/331, paras. 10, 153 and 204.]

1. This article provides for hierarchical administrative review. States where hierarchical administrative review against administrative actions, decisions and procedures is not a feature of the legal system might choose to omit this article and provide only for judicial review (article 40).

2. In some legal systems that provide for both hierarchical administrative review and judicial review, proceedings for judicial review may be instituted while administrative review proceedings are still pending, or vice versa, and rules are provided as to whether or not, or the extent to which, the judicial review proceedings supplant the administrative review proceedings. If the legal system of an implementing State that provides both means of review does not have such rules, the State may wish to establish them, e.g., in the procurement regulations.

3. An implementing State that wishes to provide for hierarchical administrative review but that does not already have a mechanism for such review in procurement matters should vest the review function in a relevant administrative body. The function may be vested in an appropriate existing body or in a new body created by the implementing State. The body may, for example, be one that exercises overall supervision and control over procurement in the State (e.g., a central tender board; see article 6 and the accompanying commentary), a relevant body whose competence is not restricted to procurement matters (e.g., the body that exercises financial and control and oversight over the operations of the Government and of the public administration (the scope of the review should not, however, be restricted to financial control and oversight)), a special administrative body whose competence is exclusively to resolve disputes in procurement matters, such as a "procurement review board", or an arbitral tribunal. It is important that the body exercising the review function be independent of the procuring entity. In addition, if the administrative body is one that, under the Model Law as implemented in the State, is to approve certain actions or decisions of, or procedures followed by, the procuring entity, care should be taken to ensure that the section of the body that is to exercise the review function is independent of the section that is to exercise the approval function.

[Working Group note: subparagraph (a) of paragraph (1), set forth within square brackets, should be retained if the Working Group were to decide, in connection with article 37, that the head of the procuring entity or of the approving authority should not be competent to entertain a complaint under that article after the procurement contract enters into force (see Working Group note preceding paragraph 1 of commentary to article 37). Otherwise, it should be omitted.]

4. The persons entitled to institute proceedings under paragraph (1)(c) are not restricted to persons who participated in the proceedings before the head of the procuring entity or of the approving authority (see article 39(2)), but include any other persons claiming to be adversely affected by a decision of the head of the procuring entity or of the approving authority.

5. With respect to paragraph (2), the means by which the person submitting the complaint establishes his entitlement to a remedy depends upon the substantive and procedural law applicable in the review proceedings.

6. Differences exist among national legal systems with respect to the nature of the remedies that bodies exercising hierarchical administrative review are competent to grant. In implementing the Model Law on Procurement, a State may include all of the remedies listed in paragraph (2), or only those remedies that an administrative body would normally be competent to grant in the legal system of that State. If in a particular legal system an administrative body can grant certain remedies that are not already set forth in paragraph (2), those remedies may be added to the paragraph. The paragraph should list all of the remedies that the administrative body may grant. [Working Group note: the approach of the present article, which specifies the remedies that the hierarchical administrative body may grant, contrasts with the more flexible approach taken with respect to the corrective measures that the head of the procuring entity or of the

approving authority may require (article 37(4)(b)). The policy underlying the approach in article 37(4)(b) is that the head of the procuring entity or of the approving authority should be able to take whatever steps are necessary in order to correct an irregularity committed by the procuring entity itself or approved by the approving authority. Hierarchical administrative authorities exercising review functions are, in some legal systems, subject to more formalistic and restrictive rules with respect to the remedies that they can grant, and the approach taken in article 38(2) seeks to avoid impinging on those rules.]

7. Paragraph 3 of the commentary to article 37, concerning the payment of compensation to the person submitting the complaint, also applies to paragraph (2)(g) of the present article. [Working Group note: the Working Group note following paragraph 3 of the commentary to article 37 also applies in respect of paragraph (2)(g) of the present article.]

8. If the procurement proceedings are terminated pursuant to paragraph (2)(h), the procuring entity may institute new procurement proceedings. The provisions of article 7 are relevant in that respect.

9. If detailed rules concerning proceedings for hierarchical administrative review do not already exist in a State implementing the Model Law on Procurement, the State may provide such rules in the procurement regulations. Rules may be provided, for example, concerning the time limit for instituting the hierarchical administrative review proceedings; the right of contractors and suppliers, other than the one instituting the review proceedings, to participate in the review proceedings (see article 39(2)); the burden of proof; the submission of evidence; and the conduct of the review proceedings.

10. Certain additional rules applicable to review proceedings under this article are set forth in article 39.

* * *

Article 39. *Certain rules applicable to review proceedings under article 37 [and article 38]*

(1) Promptly after the submission of a complaint under article 37 [or article 38], the head of the procuring entity or of the approving authority [, or the [insert name of administrative body], as the case may be,] shall notify all contractors and suppliers participating in the procurement proceedings to which the complaint relates of the submission of the complaint and of its substance.

(2) [[Variant A] Where a complaint is submitted under article 37 [or article 38], after a tender has been accepted or a procurement contract has entered into force, by a person other than the contractor or supplier whose tender has been accepted or who is a party to the procurement contract, that contractor or supplier shall be entitled to participate in the review proceedings to the same extent as the procuring entity.]

[[Variant B] Any such contractor or supplier claiming that its interests are or could be affected by the review proceedings may request to participate in the review proceedings. The head of the procuring entity or of the approving authority [, or the [insert name of administrative body], as the case may be,] shall decide whether or not the contractor or supplier may participate and, if so, the terms of such participation.]

(3) A copy of the decision of the head of the procuring entity or of the approving authority [, or of the [insert name of administrative body], as the case may be,] shall be

furnished within [5] days to the person submitting the complaint, to the procuring entity and to any other person that has participated in the review proceedings. In addition, after the decision has been issued, the complaint and the decision shall be promptly made available for inspection by the general public, provided, however, that no information shall be disclosed contrary to any law of [this State] relating to confidentiality.

* * *

Commentary

[Working Group note: This article applies only to review proceedings before the head of the procuring entity or of the approving authority, and before a hierarchical administrative body, but not to judicial review proceedings. There exist in many States rules concerning the matters addressed in this article. Those rules vary from State to State, and it may be considered unfeasible or undesirable for the Model Law on Procurement to establish a uniform rule that may conflict with those rules.]

1. References within square brackets in the heading and text of this article to article 38 and to the administrative body should be omitted by an implementing State that does not provide for hierarchical administrative review.

2. The purpose of paragraphs (1) and (2) of this article is to make contractors and suppliers aware that a complaint has been submitted concerning procurement proceedings in which they have participated or are participating and to enable them to take steps to protect their interests. Those steps may include intervention in the review proceedings under paragraph (2), and other steps that may be provided for under applicable legal rules. [Working Group note: the following sentence may be included if variant A of paragraph (2) is adopted: While paragraph (2) limits itself to the right to intervene by a contractor or supplier whose tender has been accepted or who has become a party to a procurement contract, the procurement regulations or other rules of national law might enable intervention by other contractors and suppliers participating in the procurement proceedings, and might deal with intervention even before a tender has been accepted or a procurement contract has entered into force (see paragraph 5 of commentary to article 37 and paragraph 10 of commentary to article 38).]

[Working Group note: variant A is intended to ensure that the right to participate in the review proceedings is available at least to a contractor or supplier whose tender has been accepted or who has entered into a procurement contract. Under variant B, any contractor or supplier participating in the procurement proceedings, who claims that his interests are or could be affected by the review proceedings, could request to intervene, but the decision upon such a request is left to the forum of the review proceedings. A distinction is made in variant A between the time of acceptance of a tender (when tendering proceedings are used) and the time of entry into force of the procurement contract (when other means of procurement are used) because, under draft article 32, when the entry into force of the procurement contract is subject to the signature of a written contract, a time gap may exist between the time a tender has been accepted and the time the contract enters into force.]

3. In paragraph (3), "any other person that has participated in the review proceedings" refers to contractors and suppliers participating pursuant to paragraph (2) and any other persons permitted to participate in the review proceedings under the legal rules and practices applicable to those proceedings.

* * *

Article 40. Judicial review

The [insert name(s) of court(s)] shall have jurisdiction over an action commenced by a person referred to in article 36 to review an act or decision of, or a procedure followed by, the procuring entity. Such an action may be commenced by the person:

[(a) as an alternative to submitting a complaint under article 38;]

[(b) if his complaint cannot be submitted or entertained under article 37 because of the entry into force of the procurement contract;]

[(c) pursuant to paragraph (5) of article 37;] or

(d) if the person claims to be adversely affected [by a decision of the head of the procuring entity or of the approving authority under article 37] [or] [by a decision of the [insert name of administrative body] under article 38].

* * *

Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 221, 226; A/CN.9/315, paras. 115, 116, 119-121; A/CN.9/331, paras. 153 and 204.]

1. This article provides for judicial proceedings. It confers jurisdiction on the specified court or courts, and specifies the circumstances in which an action may be commenced. The procedural and other aspects of the judicial proceedings, including the remedies that may be granted, will be governed by the law applicable to the proceedings. [Working Group note: that minimalist approach has been adopted so as to avoid impinging on national laws and procedures relating to judicial proceedings.]

2. Subparagraph (a), which appears within square brackets, should be omitted by a State that does not provide hierarchical administrative review, or that requires a person to exhaust his right to hierarchical administrative review under article 38 before seeking judicial review. It should be retained by an implementing State that provides hierarchical administrative review but that does not have that requirement.

[3. Subparagraph (b), which appears within square brackets, should be omitted by a State requiring the person seeking review to exhaust his right to hierarchical administrative review before seeking judicial review. It should be retained by a State that does not have that requirement or that does not provide hierarchical administrative review.] [Working Group note: subparagraph (b) and the preceding paragraph of the commentary should be included if the Working Group were to decide, in connection with article 37, that the head of the procuring entity or of the approving authority should not be competent to entertain a complaint under that article after the procurement contract enters into force (see Working Group note preceding paragraph 1 of commentary to article 37). Otherwise, they should be omitted.]

4. Subparagraph (c), which appears within square brackets, should be omitted by an implementing State that requires the person seeking review to exhaust his right to hierarchical administrative review before seeking judicial review, but should be retained by a State that does not have that requirement or that does not provide hierarchical administrative review.

5. An implementing State should take the following action with respect to the references set forth within square brackets in subparagraph (d). If the implementing State does not provide hierarchical administrative review, the reference should be only

to a decision of the head of the procuring entity or of the approving authority under article 37. If the implementing State provides both hierarchical administrative review and judicial review and does not require the person seeking review to exhaust his right to hierarchical administrative review before seeking judicial review, the reference should be to a decision of the head of the procuring entity or of the approving authority under article 37 "or" a decision of the administrative body under article 38. If the implementing State provides both forms of review but requires the person seeking review to exhaust his right to hierarchical administrative review before seeking judicial review, the reference should be only to a decision of the administrative body under article 38.

6. The law applicable to the judicial proceedings will govern the question of whether, in an action commenced pursuant to subparagraph (d), the court is to examine *de novo* the aspect of the procurement proceedings complained of, or is only to examine the legality or propriety of the decision reached in the review proceedings under article 37 or 38.

* * *

Article 41. *Suspension of procurement proceedings [and of performance of procurement contract]*

[Variant A] The timely submission of a complaint under article 37 [or article 38] or the timely commencement of an action under article 40 shall suspend the procurement proceedings [, or the performance of the procurement contract, if it has entered into force,] pending the disposition of the review proceedings unless the head of the procuring entity or of the approving authority, [the [insert name of administrative body]] or the court, as the case may be, determines that the suspension would not be in the public interest.

[Variant B] After the timely submission of a complaint under article 37 [or article 38], or the timely commencement of an action under article 40, the head of the procuring entity or of the approving authority, [the [insert name of administrative body]] or the court, as the case may be, may suspend the procurement proceedings [, or the performance of the procurement contract, if it has entered into force,] in order to preserve the rights of the person submitting the complaint or commencing the action pending the disposition of the review proceedings.

* * *

Commentary

1. The purpose of this article is to enable the rights of the person instituting review proceedings to be preserved pending the disposition of those proceedings. [Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 224 and 225; A/CN.9/315, paras. 117 and 118. Two variants are presented for the consideration of the Working Group. Variant A provides for automatic suspension of the procurement proceedings when review proceedings are commenced, unless the head of the procuring entity or of the approving authority, the administrative body or the court determines, on the grounds stipulated in the variant, that the procurement proceedings should not be suspended. That approach is followed in the procurement laws of some countries as an exception to a general rule in judicial or administrative proceedings that the burden is on the party seeking relief. A principal reason in support of the approach is that

a person submitting a complaint or commencing a judicial action may not have sufficient time to seek and obtain interim relief. In particular, it will usually be important for the person to avoid the entry into force of the procurement contract pending disposition of the review proceedings and, if he must establish his entitlement to interim relief, he may not have sufficient time to do so to avoid entry into force of the contract (e.g., where the procurement proceedings are in their final stages); see A/CN.9/331, para. 212. Variant B takes into account the fact that serious disruption could be caused by suspension of the procurement proceedings or performance of the procurement contract. Under that approach, the procurement proceedings or performance of the procurement contract is not suspended automatically; rather, the decision of whether or not to suspend rests with the forum.

The references in the text of the article and in the commentary to suspension of the performance of the procurement contract have been placed within square brackets to invite the Working Group to consider whether or not suspension of the contract should be provided for. Although each variant deals with suspension of performance of the procurement contract in the same manner as suspension of the procurement proceedings, it would also be possible to treat those two situations differently, for example by providing for automatic suspension of the procurement proceedings, but providing that performance of the procurement contract may be suspended only if the forum so decides.]

2. In applying the provisions of this article, the forum of the review proceedings would employ any criteria set forth in the procurement regulations or contained in other rules of law applicable to the review proceedings. Such criteria might include, for example, whether the negative consequences from suspending the procurement proceedings [or performance of the procurement contract] are disproportionate to the advantages of the suspension, and the likelihood of the claimant succeeding in the review proceedings.

3. This article does not interfere with a power that the forum of the review proceedings may have under applicable legal rules to grant other forms of interim remedies. Also, it does not interfere with a power to require the person instituting the review proceedings to supply a security to cover possible losses of the procuring entity if the procurement proceedings [or the performance of the procurement contract] are suspended but the complaint of the person seeking review is not successful.

4. The references within square brackets to article 38 and to the administrative organ will depend upon whether or not the implementing State provides hierarchical administrative review.

* * *

Article 42. *Disciplinary, administrative or criminal responsibility of procuring entity*

The results of review proceedings under this chapter shall have no effect on any disciplinary, administrative or criminal responsibility that the procuring entity, or an officer or employee thereof, may bear under the law of [this State].

* * *

[Working Group note: see A/CN.9/331, para. 151.]

ANNEX II

DRAFT RECOMMENDATION OF THE COMMISSION TO ACCOMPANY ITS ADOPTION
OF THE MODEL LAW ON PROCUREMENT

[Working Group note: the following recommendation could be included in the decision of the Commission adopting the Model Law on Procurement, or it could be adopted as a separate decision, with appropriate additional preambular language. The recommendation has been modelled on articles 1 and 2 of the EC review Directive. Some provisions of the Directive that may be necessary or appropriate because of the mandatory character of the Directive have been omitted from the recommendation or have been modified where it was believed that the provisions in question were unnecessary or inappropriate in a recommendation. Other changes have been made to accord with the terminology or concepts used in the Model Law on Procurement.]

The United Nations Commission on International Trade Law,

...

Being convinced that an effective means to review the lawfulness of acts and decisions of, and procedures followed by, procuring entities in the context of procurement covered by the Model Law on Procurement is essential to guard against misapplication of the Model Law or of procurement regulations adopted thereunder, to ensure the proper functioning of national procurement systems and to promote confidence in those systems,

Recommends to Governments:

1. that they take the measures necessary to ensure that, as regards procurement falling within the scope of the Model Law on Procurement, the lawfulness of acts and decisions of, and procedures followed by, procuring entities may be reviewed effectively;

2. that they ensure that there is no discrimination between foreign and domestic persons with respect to the right to seek

and obtain review or with respect to any other aspect of the review proceedings;

3. that they ensure that review proceedings are available at least to any person having or having had an interest in obtaining a particular procurement contract and who suffers or risks suffering detriment as a result of an unlawful act or decision of, or procedure followed by, a procuring entity in the context of procurement;

4. that they ensure that the review proceedings referred to in the foregoing paragraphs include provision for the powers:

(a) to take, at the earliest opportunity, interim measures with the aim of preventing further detriment to the person concerned, including measures to suspend or to ensure the suspension of the procurement proceedings, the implementation of any decision taken by the procuring entity or the performance of the procurement contract;

(b) either to set aside or to ensure the setting aside of decisions taken unlawfully;

(c) to award compensation to persons suffering detriment as a result of an unlawful act, decision or procedure;

5. that they ensure that decisions taken by bodies responsible for review proceedings can be effectively enforced;

6. that written reasons for decisions in review proceedings before non-judicial bodies shall always be given;

7. that, even where non-judicial review proceedings are provided, provision also be made for judicial review proceedings;

8. that, except in the case of review proceedings instituted in the first instance before the procuring entity, the bodies responsible for review proceedings be independent of the procuring entity.

2. Procurement: second draft of articles 1 to 35 of Model Law on Procurement: report of the Secretary-General (A/CN.9/WG.V/WP.28) [Original: English]

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INTRODUCTION

1. The Commission decided at its nineteenth session in 1986 to undertake work in the area of procurement as a matter of priority and entrusted that work to its Working Group on the New International Economic Order (A/41/17, para. 243). The Working Group commenced its work at its tenth session in October 1988. It devoted that session to deliberations on the basis of a study of procurement prepared by the Secretariat that discussed possible objectives of national procurement policies and that examined national procurement laws and practices and the roles and activities of various international institutions and development funding agencies in connection with procurement (A/CN.9/WG.V/WP.22). After completing its consideration of the study the Working Group requested the Secretariat to prepare a first draft of a Model Law on Procurement and an accompanying commentary taking into account the discussions and decisions at the session (A/CN.9/315, para. 125).

2. The first draft of articles 1 to 35 of the Model Law on Procurement and the accompanying commentary prepared by the Secretariat (A/CN.9/WG.V/WP.24 and A/CN.9/WG.V/WP.25) were considered by the Working Group at its eleventh session in February 1990. (The draft articles contained in those documents is hereinafter referred to as the "first draft".) Draft provisions on review of acts and decisions of, and procedures followed by, the procuring entity were not included in the first draft and were to be prepared subsequent to the preparation of that draft.

3. After considering the first draft and the accompanying commentary, the Working Group requested the Secretariat to revise the text of the Model Law taking into account the discussion and decisions at that session of the Working Group. It was agreed that the revision need not attempt to perfect the structure or drafting of the text. It was also agreed that the commentary would not be revised until after the text of the Model Law had been settled, and that no revision of the commentary would be prepared for the twelfth session of the Working Group. In addition, the Working Group requested the Secretariat to prepare for the twelfth session draft provisions on the review of acts and decisions of, and procedures followed by, the procuring entity (A/CN.9/331, para. 222). The revision of draft articles 1 to 35 of the Model Law is contained in the present document; draft provisions on review, consisting of articles 36 to 42, are contained in A/CN.9/WG.V/WP.27.

4. In preparing the present draft, the Secretariat has sought to incorporate all deletions, changes and additions agreed upon by the Working Group at its eleventh session. In addition, an attempt has been made to incorporate proposals and suggestions made at that session but in respect of which agreement was not reached. Wording reflecting proposals and suggestions upon which agreement was not reached at the eleventh session are, in most cases, placed within square brackets. However, wording reflecting proposals and suggestions that, it is believed, are not likely to be controversial or to encounter opposition (e.g., improvements in drafting that do not affect the substance of the text) have not been placed within square brackets. Proposals and suggestions have not been reflected in the text where they would conflict with an approach agreed upon by the Working Group or where

they would for other reasons be difficult to incorporate. Such proposals and suggestions were few in number.

5. In the present draft, changes of and additions to wording that appeared in the first draft are underlined, except in the case of headings to articles, all of which are underlined as a matter of style. Deletions from the first draft are indicated in the notes following each article.

6. The present draft may serve as a useful compendium of elements that the Working Group considers are, or that may be, important for an efficient, effective and fair procurement system, and thus may facilitate the further work of the Working Group in the area of procurement. It will be observed, however, that the addition to the text of the wording and provisions upon which the Working Group has agreed makes the text longer, more complex and more cumbersome; further additions will make the text even more so. Those characteristics, particularly in a Model Law intended for global application, can impede the usefulness and acceptability of the text. In considering the present draft, the Working Group may wish to re-examine critically each provision of the text with respect to the possibility of rendering the text less complex and cumbersome as well as from the point of view of substance. For example, in the light of the early decision of the Working Group that the Model Law should be a "framework" law, setting forth only the essential elements of procurement procedure, some matters of detail that currently appear in the text might be left to be dealt with in the procurement regulations.

7. Unless otherwise indicated in the notes accompanying the draft articles, the Secretariat will, in preparing the next draft of the Model Law, proceed on the assumption that proposals and suggestions for changes and additions in respect of which the Working Group took no decision at its eleventh session (such proposals, suggestions and provisions being reflected in the present (second) draft within square brackets) are not to be incorporated in the text, except those that the Working Group affirmatively decides to retain or to modify. Additions that are not retained or modified by the Working Group will be deleted from the text; where necessary, the wording of the first draft will be reinstated. With respect to changes to wording that appeared in the first draft that are not retained or modified by the Working Group, the wording used in the first draft will be reinstated.

SECOND DRAFT OF ARTICLES 1 TO 35
OF MODEL LAW ON PROCUREMENT

Chapter I. General provisions

Article 1. *Application of Law**

(1) This Law applies to procurement by procuring entities.¹

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

¹The remainder of the text of article 1 in the first draft has been deleted and is incorporated in the definition of "procurement" that has been added in new subparagraph (a) of article 2. See note 1 to article 2.

(2) *This Law does not apply to procurement for national security or national defence purposes, except where the procuring entity expressly declares that it applies.*²

²See A/CN.9/331, para. 139.

* * *

Article 2. Definitions

For the purposes of this Law:

[(new a) "procurement" means the acquisition, through purchase, rental, lease, hire-purchase or any other means, of goods or of construction, including services incidental to the supply of the goods or to the construction if the value of those incidental services does not exceed that of the goods or construction themselves[, and the acquisition of telecommunications, transport or insurance services].]¹

(a) "procuring entity" means:

- (i) any department, agency, organ or other unit, or any subdivision thereof, of the Government or the administration[, *except. . .*];²
- (ii) (each State enacting this Model Law inserts in this subparagraph and, if necessary, in subsequent subparagraphs, other entities or enterprises, or categories thereof, to be included in the definition of "procuring entity");

(b) "goods" includes raw materials, products, equipment and other physical objects of every kind and description[, *whether in solid, liquid or gaseous form, and electrical, nuclear and other energy*];³

(c) "construction" means such physical work as site preparation, excavation, erection, [*demolition,*] building, installation of equipment or materials, decoration and finishing, in respect of a new structure or of an existing structure[, *as well as drilling, mapping, satellite photography, seismic studies and similar activities in connection with such work*];⁴

(d) "procurement proceedings" [*includes*] tendering proceedings, competitive negotiation proceedings and single source procurement;⁵

(e) "international tendering proceedings" means [*tendering proceedings in which participation by contractors and suppliers whose places of business or habitual residences are located outside (this State) is encouraged and promoted through the use of particular procedures provided for by this Law*];⁶

(f) "tender security" includes such arrangements as guarantees [*issued by financial institutions*];⁷ letters of credit, cheques on which a bank is primarily liable and cash deposits, provided by a contractor or supplier to secure obligations in respect of its tender;

(g) "currency" includes unit of account;

(g bis) "tendering proceedings" means procedures engaged in, in accordance with articles 11 through 33, with a view towards entering into a procurement contract;⁸

(h) "competitive negotiation proceedings" means [*negotiations on a competitive basis between the procuring entity and contractors and suppliers, governed by article 34, with a view towards entering into a procurement contract*];⁹

(i) "single source procurement" means procurement from a particular contractor or supplier without engaging in tendering proceedings or competitive negotiation proceedings;

(i bis) "contractor or supplier" means any party or potential party, according to the context, to a procurement contract with the procuring entity;⁸

(j) a tender is "responsive" if it conforms to the requirements set forth in the solicitation documents, including requirements concerning the characteristics of the goods, construction [or services] to be procured and the terms and conditions of the procurement contract.¹⁰

¹The definition of "procurement" has been added pursuant to the suggestion in A/CN.9/331, para. 27. It incorporates the suggestions and proposals in A/CN.9/331, paras. 17, 18 and 23. If this addition is not adopted, article 1(1) will be reformulated along the lines of the first draft. The Working Group may wish to consider whether it is desirable to list the various means of acquisition, or whether it would be preferable to refer simply to acquisition by any means except by gift.

²See A/CN.9/331, para. 23.

³See A/CN.9/331, para. 23. The phrase "physical objects" replaces the phrase "tangible objects" that appeared in the first draft.

⁴See A/CN.9/331, para. 24.

⁵The changes in this subparagraph, consisting of the addition of the word "includes" and the deletion of wording that appeared in the first draft, have been made on the initiative of the Secretariat.

⁶See A/CN.9/331, para. 23.

⁷See A/CN.9/331, para. 25.

⁸Added on the initiative of the Secretariat.

⁹See A/CN.9/331, para. 26.

¹⁰The definition of "responsive" tender has been relocated from article 28(4)(a) of the first draft, pursuant to A/CN.9/331, para. 156. The reference to services has been included within square brackets in the light of the possibility of including certain services in new subparagraph (a) of this article.

* * *

Article 3. Underlying [objectives]¹

[*The [objectives] of this Law are, consistent with the efficient operation of the procurement system of (this State).*]²

(a) to maximize economy in procurement;

(b) to foster and encourage participation in procurement proceedings by competent contractors and suppliers, including, where appropriate, [*participation by contractors and suppliers whose places of business or habitual residences are located outside (this State)*];³

(c) to promote competition among contractors and suppliers for the supply of the goods, construction [or services]⁴ to be procured;

(d) to provide for the fair and equitable treatment of all contractors and suppliers in connection with procurement covered by this Law;

(e) to promote the integrity of, and fairness and public confidence in, the procurement process; and

(f) to achieve transparency in the procedures relating to procurement.

¹Pursuant to the suggestion in A/CN.9/331, para. 30, the word "objectives" replaces the word "policies" that appeared in the first draft. Paragraph (2) of this article, which appeared in the first draft, has been moved to a separate article (article 3 *bis*) and reworded.

²The reference to "efficiency", which appeared in subparagraph (a) in the first draft, has been moved to the *chapeau* of the article, pursuant to the proposal in A/CN.9/331, para. 31. The Working Group may wish to consider whether the objectives in subparagraphs (a) through (f) should be subsidiary to the objective of efficiency, as they are under the present formulation, or whether the objective of efficiency should have the same status as the other objectives, as it did in the first draft.

³The wording of the first draft has been modified to align with the modification made to the definition of "international tendering proceedings" in article 2(e).

⁴See note 8 to article 2.

* * *

Article 3 *bis*. *International agreements or other international obligations of (this State) relating to procurement*

To the extent that this Law conflicts with an obligation of (this State) under any treaty or other form of agreement to which it is a party with one or more other States or under any agreement with an international financing institution, that has already been or is subsequently entered into by (this State), the requirements of such obligation shall be applied; but in all other respects, the procurement shall be governed by this Law.¹

¹The substance of this article originally appeared as paragraph (2) of article 3. It has been reworded in accordance with A/CN.9/331, para. 33, and placed in a separate article.

* * *

Article 4. *Procurement regulations*

The . . . (each State enacting this Model Law specifies the organ or authority authorized to promulgate the procurement regulations) is authorized to promulgate procurement regulations to elaborate upon or supplement this Law.

Article 5. *Public accessibility of procurement law, procurement regulations and other legal texts relating to procurement*

This Law and the procurement regulations, all administrative rulings and directives of general application in connection with procurement covered by this Law, and all amendments of this Law and those regulations and administrative rulings and directives, shall be promptly made accessible to the public.

[Article 6. *Control and supervision of procurement*¹

(1) The approval function referred to in articles 7(2), 7(3), 12(2), 28(3), 29(1) and 31(1) shall be performed by . . . (each State enacting this Model Law specifies the organ or authority authorized to perform the approval function).

(2) (Each State enacting this Model Law specifies in this paragraph and, if necessary, in subsequent paragraphs, any additional functions in connection with the control and supervision of procurement and the organ(s) or authority(ies) to perform those functions.)]

¹This article has been placed within square brackets because of a possible inconsistency in decisions of the Working Group at its eleventh session with respect to the approval function. The approval function was discussed initially in A/CN.9/331, paras. 36 to 38. In A/CN.9/331, paras. 176 and 194, the Working Group agreed that the approval function should be dealt with in the implementing regulations and not in the Model Law. That decision would seem to call for the deletion of article 6 and of all references in the Model Law to the necessity of the procuring entity to obtain approval of an act or decision. However, in connection with article 28(3), the prevailing view of the Working Group was that the requirement that the procuring entity had to obtain approval of a decision to reject a tender under that provision should be retained (A/CN.9/331, para. 152). The Working Group may wish to remedy the apparent inconsistency.

* * *

Article 7. *Methods of procurement and conditions for their use*

(1) Except as otherwise provided by this Law, a procuring entity engaging in procurement shall do so by means of tendering proceedings.

(2) [Subject to approval,¹ the procuring entity may engage in procurement by means of competitive negotiation proceedings:

(a) when the [estimated value]² of the procurement contract is less than the amount set forth in the procurement regulations; or

(b) when tendering proceedings have been engaged in but [no tenders were submitted, or]³ all tenders were rejected by the procuring entity pursuant to article 28(2) or (3) or article 29, [and when engaging in new tendering proceedings would be unlikely to result in a procurement contract].⁴

(3) [Subject to approval,¹ the procuring entity may engage in single source procurement when:

(a) the [estimated value]² of the procurement contract is less than the amount set forth in the procurement regulations;

(b) the goods, construction [or services] is available only from a particular contractor or supplier, [or a particular contractor or supplier has exclusive rights in respect of the goods, construction [or services], and] no reasonable alternative or substitute exists;⁵

(c) there is an urgent need for the goods, construction [or services] making it impossible or imprudent to use

tendering proceedings or competitive negotiation proceedings, as the case may be, because of the amount of time involved in using those proceedings;

(d) for reasons of standardization, or the need for compatibility with existing [goods,] equipment or technology, [additional supplies] must be procured from [the] contractor or supplier [that supplied the existing goods, equipment or technology];³

(e) the procuring entity seeks to enter into a contract with the contractor or supplier for the purpose of research, experiment, study or development, except where the contract includes the production of goods in quantities to establish their commercial viability or to recover research and development costs;

(f) for [the protection] of national security [or for reasons of national defence] there is a need for secrecy in respect of the procuring entity's procurement needs;⁶

(g) [procurement from a particular contractor or supplier is necessary in order to promote socio-economic policies specified in the procurement regulations];⁷

(h) [procurement from a particular contractor or supplier is necessary in order to develop a particular source of supply for reasons of national security or national defence];³

(i) [the scope or volume of the goods, construction [or services] required by the procuring entity exceeds the normal capacity of the relevant industry and a particular contractor or supplier is willing to build or acquire special facilities or capacity in order to supply the goods, construction [or services].]³

(4) The procuring entity shall not divide its procurement into separate contracts for the purpose of invoking paragraph (2)(a) or (3)(a).⁸

(5) A procuring entity that invokes the provisions of paragraph (2) or (3) shall include in the record required under article 34(4) or article 35, as the case may be,⁹ a statement of the circumstances on which it relied and, except in respect of paragraph (3)(f), shall specify the relevant facts.

¹See note 1 to article 6.

²See A/CN.9/331, para. 40.

³See A/CN.9/331, para. 42.

⁴See A/CN.9/331, para. 214. Subparagraph (b)(ii), which appeared in the first draft, has been deleted.

⁵See A/CN.9/331, para. 42. With respect to the references to services in paragraph (3)(b) and elsewhere in this article, see note 8 to article 2.

⁶See A/CN.9/331, para. 44.

⁷The Working Group may wish to consider whether, even with its scope limited to the promotion of specified socio-economic policies, subparagraph (g) would provide too much scope to a procuring entity to defeat the objectives of the Model Law.

⁸The words "of the goods or construction" that appeared in the first draft after the word "procurement" have been deleted.

⁹Pursuant to A/CN.9/331, para. 207, the word "record" replaces the word "minutes" that appeared in the first draft. The words "as the case may be" have been added to improve the clarity of the provision.

Article 8. Qualifications of contractors and suppliers¹

(new 1) This article applies to the ascertainment by the procuring entity of the qualifications of contractors and suppliers at any stage of the procurement proceedings.²

(1) Subject to the right of contractors and suppliers to protect their intellectual property or trade secrets, the procuring entity may:³

(a) require contractors and suppliers participating in procurement proceedings to provide such appropriate documentary evidence or other information as it may deem useful to satisfy itself that the contractors and suppliers:⁴

- (i) have legal capacity [according to the law of the State of which a contractor or supplier is a national] to enter into the procurement contract;^{5, 6}
- (ii) are not insolvent, [in receivership,⁵ bankrupt or being wound up, their affairs are not being administered by a court or a judicial officer, their business activities have not been suspended, and they are not the subject of legal proceedings for any of the foregoing;
- (iii) have fulfilled their obligations to pay taxes and social security contributions in (this State);
- [(iv) have not been convicted of any criminal offence concerning their professional conduct [or based on the making of false statements or misrepresentations as to their qualifications to enter into a procurement contract],⁷ [and have not been held liable in civil proceedings for loss arising from the performance or failure to perform a procurement contract,] within a period of [5] years preceding the commencement of the procurement proceedings;]⁸
- (v) [deleted];⁹
- (vi) possess sufficient technical competence, financial resources, equipment and other physical facilities, [managerial capability, reliability, experience, and reputation], and sufficient personnel, to perform the procurement contract;¹⁰

(b) investigate by any other appropriate means [, including by inspection of the books of the contractor or supplier,] the qualifications of the contractor or supplier pursuant to criteria set forth in subparagraph (a).¹¹

(2) Any requirement established pursuant to paragraph (1)(a) and any criterion established by the procuring entity for the evaluation of the qualifications of contractors and suppliers under paragraph (1)(a)(vi) shall be set forth in the prequalification documents, if any, and in the solicitation documents and shall apply equally to all contractors and suppliers. A procuring entity shall impose no requirement or qualification criterion other than those provided for in paragraph (1)(a).¹²

(2 bis) The procuring entity shall evaluate the qualifications of contractors and suppliers in accordance with the

*qualification criteria and procedures set forth in the pre-qualification documents and the solicitation documents.*¹³

(2 *ter*) [In the case of international tendering proceedings, the procuring entity shall establish no criterion, requirement or procedure with respect to the qualifications of contractors and suppliers [that discriminates against foreign contractors and suppliers or against categories thereof].¹⁴

(3) [Subject to the efficient operation of the procurement system,] a contractor or supplier shall not be precluded from participating in procurement proceedings for the reason that it has not demonstrated that it is qualified pursuant to paragraph (1) if the contractor or supplier undertakes to demonstrate that it is qualified during the course of the procurement proceedings and if it is reasonable to expect that the contractor or supplier will be able to do so.¹⁵

¹³Pursuant to A/CN.9/331, para. 45, the substance of article 9 that appeared in the first draft has been merged with the present article; the article refers only to the "qualifications" of contractors and suppliers, and not to their "eligibility".

¹⁴See A/CN.9/331, para. 70. The words "at any stage of the procurement proceedings" are intended to include the postqualification proceedings provided for in article 28(8 *bis*). Although the agreement of the Working Group called for an express reference to postqualification proceedings, the more generalized formulation contained in this paragraph is presented for the consideration of the Working Group. It clarifies that not only postqualification proceedings, but also the evaluation of the qualifications of contractors and suppliers at any other stage of the procurement proceedings, are subject to the criteria, requirements and procedures provided for in article 8 (see A/CN.9/331, para. 78).

¹⁵See A/CN.9/331, para. 46; paragraph (1) has been restructured.

¹⁶Pursuant to the proposal in A/CN.9/331, para. 47, the reference to "written statements" has been deleted.

¹⁷See A/CN.9/331, para. 48.

¹⁸The Working Group may wish to note that in many legal systems the applicable law for determining the capacity of a party to enter into a contract would not necessarily be the law of the country of which the party is a national.

¹⁹See A/CN.9/331, para. 53.

²⁰Pursuant to A/CN.9/331, para. 49, the entire subparagraph has been placed within square brackets in the light of the differing opinions as to whether it should be retained. The subparagraph will be deleted if not affirmatively acted upon by the Working Group. The reference to civil liability has been added but placed within square brackets pending a decision by the Working Group as to whether or not it should be included. The Working Group may wish to note that, under that ground, a contractor or supplier would be disqualified for [5] years even where it acted generally in good faith in connection with the prior contract and its improper or non-performance of that contract was relatively minor. If the ground for exclusion is to be retained at all, it should perhaps be narrowed considerably.

²¹See A/CN.9/331, para. 50.

²²The foregoing provision has been moved to the present article from article 9 as it appeared in the first draft, pursuant to A/CN.9/331, para. 45. The references to managerial capability, reliability, experience and reputation have been added pursuant to proposals in A/CN.9/331, para. 53.

²³Pursuant to A/CN.9/331, para. 45, the word "eligibility" that appeared in this subparagraph and elsewhere in the article the first draft has been changed to "qualifications". The reference to inspection of the books of a contractor or supplier has been added pursuant to the proposal in A/CN.9/331, para. 51.

²⁴The indicated wording in the first sentence of paragraph (2) is a reformulation of the wording that originally appeared in the paragraph, as a consequence of the merger of article 15 with the present article (see A/CN.9/331, para. 66).

²⁵The substance of this provision originally appeared as paragraph (1) of article 15, which has been merged with the present article pursuant to

A/CN.9/331, para. 66. In the first sentence, the word "evaluate" replaces the word "assess", pursuant to A/CN.9/331, para. 67; the word "requirements" has been added; and the reference to "solicitation" documents replaces the reference to "procurement" documents pursuant to A/CN.9/331, para. 28.

²⁶The substance of the foregoing paragraph originally appeared as paragraph (3) of article 15, which has been merged with the present article pursuant to A/CN.9/331, para. 66. The reference to discrimination against foreign contractors and suppliers or categories thereof replaces the original formulation in paragraph (3) of article 15, pursuant to A/CN.9/331, paras. 67 and 69.

²⁷The square brackets surrounding this paragraph as it appeared in the first draft have been removed, pursuant to the decision of the Working Group to retain a provision along the lines of the paragraph (A/CN.9/331, para. 52). The opening words of the paragraph have been added pursuant to a proposal in A/CN.9/331, para. 52. The Working Group may wish to consider whether those words give too much scope for arbitrary exclusion of a contractor or supplier from participation in the procurement proceedings. The other indicated wording is a reformulation of wording that appeared in the original version of the paragraph.

* * *

Article 9. [Merged with article 8]¹

¹See A/CN.9/331, para. 45.

* * *

[Article 10. *Rules concerning documentary evidence provided by contractors and suppliers*¹

(1) This article applies to documentary evidence provided by contractors and suppliers to demonstrate their qualifications in procurement proceedings, *when the procuring entity requires that the documentary evidence be legalized*.²

(2) Documentary evidence other than that emanating from a governmental, judicial or administrative authority, shall be signed and sworn to or otherwise solemnized by the maker of the document before a notary or other authority competent under the law of the place where the authority serves to attest to the authenticity of the document and to its signature and solemnization, and the attestation of the notary or other competent authority shall be affixed or joined to the document. The attestation by a foreign notary or other competent authority shall be acceptable if it is legalized in accordance with the law applicable in (this State) relating to the legalization of foreign public documents;

(3)(a) Documentary evidence emanating from a governmental, judicial or administrative authority outside (this State) shall be acceptable if it is legalized in accordance with the law applicable in (this State) relating to the legalization of foreign public documents;

(b) Documentary evidence emanating from a governmental, judicial or administrative authority in (this State) shall conform to the law applicable in (this State) concerning the signature, solemnization and legalization of such documents.]

¹This article has been placed within square brackets pursuant to A/CN.9/331, para. 56, where it is questioned whether or not the article should be retained at all. The article will be deleted if not affirmatively

acted upon by the Working Group. References in the title and text of the article to "written statements" have been deleted pursuant to the proposal in A/CN.9/331, para. 47.

²Pursuant to A/CN.9/331, para. 45, the words "eligibility and" that appeared before the word "qualifications" in the first draft have been deleted. The final words of the paragraph have been added pursuant to A/CN.9/331, para. 56.

* * *

Chapter II. Tendering proceedings

Section I. International tendering proceedings

Article 11. International tendering proceedings

A procuring entity that is required under article 7 to engage in tendering proceedings may decide to engage in international tendering proceedings, taking into account the objectives of economy and efficiency in the procurement.¹

¹Paragraph (2) that appeared in the first draft of this article, and the reference to paragraph (2) that appeared in paragraph (1), have been deleted pursuant to A/CN.9/331, para. 58, which reflects the decision of the Working Group that international tendering proceedings should not be mandatory. The reference in A/CN.9/331, para. 58, to examples of cases where international tendering proceedings would be desirable has not been included, since it might be more appropriate for such examples to be given in the commentary, rather than in the article itself.

* * *

Section II. Solicitation of tenders and applications to prequalify

Article 12. Solicitation of tenders and applications to prequalify

(1) A procuring entity shall solicit tenders, and, where applicable, applications to prequalify, from all interested contractors and suppliers by causing a notice of proposed procurement to be published in . . . (each State enacting this Model Law specifies the official gazette or other official publication in which the notice of proposed procurement is to be published). In international tendering proceedings, the notice of proposed procurement shall also be published, *in a language customarily used in international trade, in a newspaper or relevant trade publication or technical journal of wide international circulation. [The foregoing provisions do not preclude the use of additional means of bringing the notice of proposed procurement to the attention of contractors and suppliers.]*¹

(2)(a) *[Notwithstanding the provisions of paragraph (1),]*²

[[alternative 1] where restricted participation in the tendering proceedings is more conducive to economy and efficiency,]

[[alternative 2] where the time and costs involved in soliciting, examining, evaluating and comparing tenders

*from all interested contractors and suppliers is disproportionate to the estimated value of the procurement contract, where the goods or construction to be procured are available only from a small number of contractors and suppliers known to the procuring entity and it is more conducive to economy and efficiency in procurement to solicit tenders only from those contractors and suppliers, or where soliciting tenders from all interested contractors and suppliers could impede effective competition by deterring the submission of tenders by qualified contractors and suppliers.]*³

the procuring entity may [, subject to approval,]⁴ solicit tenders by *communicating*⁵ the notice of proposed procurement only to particular contractors and suppliers selected by it. The procuring entity shall select a sufficient number of contractors and suppliers to ensure effective competition, consistent with the efficient conduct of the tendering proceedings.

*[(b) The notice of proposed procurement may be communicated to contractors and suppliers in writing or by any other means that provides a record of the contents of the notice. However, where there is an urgent need for the goods, construction [or services]⁶ to be procured or where the estimated value of the procurement contract is less than the amount set forth in the procurement regulations, tenders may be solicited from the selected contractors and suppliers by informing them of the contents of the notice of proposed procurement by telephone and communicating the notice of proposed procurement to them immediately thereafter in writing or by any other means that provides a record of the contents of the notice.]*⁷

¹The second sentence has been restructured to make it clear that the language requirement applies only where international tendering proceedings are used. The final sentence has been added pursuant to the proposal in A/CN.9/331, para. 60. The wording is intended to encompass any means of bringing the notice of proposed procurement to the attention of contractors and suppliers, including by electronically transmitted message or telephone.

²See A/CN.9/331, para. 61. Paragraph (2) has been restructured into two subparagraphs as a consequence of the addition of the provision set forth in paragraph (2)(b).

³The two alternative versions of paragraph (2)(a) are presented pursuant to the suggestion in A/CN.9/331, para. 61. The Working Group may wish to consider the possibility of retaining alternative 1 with the expectation that a more detailed rule, such as the one contained in alternative 2, could be included in the procurement regulations.

⁴See note 1 to article 6.

⁵The word "communicating" replaces the word "sending" that appeared in the first draft, so as to avoid an implication that the notice must be in the form of a written document.

⁶See note 8 to article 2.

⁷See A/CN.9/331, paras. 60 and 117.

* * *

Article 13. [Deleted]¹

¹See A/CN.9/331, para. 62.

* * *

Article 14. *Contents of notice of proposed procurement*

(1) The notice of proposed procurement shall contain at least¹ the following information:

- (a) the name and address of the procuring entity;
- (b) the nature and quantity of the goods *[or services]*² to be supplied or the nature and location of the construction to be effected;
- (c) the desired or required time for the supply of the goods *[or services]*² or for the completion of the construction;
- (d) the criteria to be used for evaluating the qualifications of contractors and suppliers, in conformity with article 8(1)(a);³
- (e) the means of obtaining the solicitation documents and the place from which they may be obtained;⁴
- (f) the price, if any, charged by the procuring entity for the solicitation documents and, in the case of international tendering proceedings, the currency and means of payment for those documents;
- (g) in the case of international tendering proceedings, the language or languages in which the solicitation documents are available;
- (h) the place and deadline for the submission of tenders;
- (i) if a tender security is required, the nature and amount of the security;⁵
- (j) the right under article 36 of this Law to seek review of an unlawful act or decision of, or procedure followed by, the procuring entity in relation to the procurement proceedings.⁵

(2) If prequalification proceedings are to be engaged in, the notice of proposed procurement shall so state. In such a case, the notice of proposed procurement need not contain the information referred to in paragraph (1)(e) or (g), but shall contain the following additional information:

- (a) the means of obtaining the prequalification documents and the place from which they may be obtained;
- (b) the price, if any, charged by the procuring entity for the prequalification documents and, in the case of international tendering proceedings, the currency and terms of payment for those documents;
- (c) in the case of international tendering proceedings, the language or languages in which the prequalification documents are available; and
- (d) the place and deadline for the submission of applications to prequalify.

¹See A/CN.9/331, para. 64.

²See note 8 to article 2.

³See A/CN.9/331, para. 45.

⁴Pursuant to the proposal in A/CN.9/331, para. 28, references to "procurement documents" in this subparagraph and elsewhere in the article have been changed to "solicitation documents".

⁵Subparagraphs (i) and (j) have been added pursuant to A/CN.9/331, para. 64. The Working Group may wish to consider whether it is necessary to require notice of proposed procurement to contain the information called for by those subparagraphs, particularly information concerning the

right to review, especially if that information must be provided in the solicitation documents (see note 18 to article 18). Draft article 36 and other draft provisions concerning the right of review are contained in A/CN.9/WG.V/WP.27.

* * *

Article 15. [Merged with article 8]¹

¹Pursuant to the suggestion in A/CN.9/331, para. 66, the substance of this article has been merged with article 8 in the following manner: paragraphs (1) and (3) of article 15 have been slightly reformulated and have become, respectively, paragraphs (3) and (4) of article 8; paragraph (2) of article 15 has been deleted. The heading preceding article 15 ("Section III. Qualifications of contractors and suppliers") has been changed and relocated to appear immediately preceding article 16.

* * *

Section III. *Prequalification of contractors and suppliers*¹

¹This heading has been changed and relocated as a consequence of the merger of article 15 with article 8.

* * *

Article 16. *Prequalification proceedings*

(1) The procuring entity may engage in prequalification proceedings with a view towards identifying, prior to the submission of tenders, contractors and suppliers that are qualified. *[However, prequalification proceedings shall not be engaged in where participation in tendering proceedings is restricted pursuant to article 12(2).]* *[The provisions of article 8 shall apply to prequalification proceedings.]*¹

(2) If the procuring entity engages in prequalification proceedings, it shall provide a set of prequalification documents to each contractor and supplier that requests them in accordance with the procedures specified in the notice of proposed procurement and that pays the price, if any, charged for those documents.

(3) The prequalification documents shall contain all information necessary to enable contractors and suppliers to prepare and submit applications to prequalify, including, but not limited to, the information required to be included in the notice of proposed procurement pursuant to article 14(1), except subparagraph (e) thereof, plus the following information:

(a) instructions for preparing and submitting prequalification applications;

[(b) any additional information concerning the goods *[or services]* to be supplied or the construction to be effected that would be useful to contractors or suppliers in preparing their prequalification applications;]²

(c) a summary of the principal required terms and conditions of the procurement contract to be entered into as a result of the tendering proceedings;

(d) any documentary evidence or other information that must be submitted by contractors and suppliers to demonstrate their qualifications;³

(e) the criteria and procedures to be used for evaluating the qualifications of contractors and suppliers;⁴

(f) the manner and place for the submission of applications to prequalify and the deadline for the submission, expressed as a specific date and time and allowing sufficient time for contractors and suppliers to prepare and submit their applications, paying particular regard, in the case of international tendering proceedings, to the time reasonably needed by foreign contractors and suppliers and taking into account the reasonable needs of the procuring entity;⁵

(g) any other requirements established by the procuring entity in conformity with this Law and the procurement regulations relating to the preparation and submission of applications to prequalify and to the prequalification proceedings;

(h) [deleted]⁶

(3 bis) *The procuring entity shall respond promptly to any request by a contractor or supplier for clarification of the prequalification documents that is received by the procuring entity prior to the deadline for the submission of applications to prequalify. The response by the procuring entity, which shall not identify the source of the request, shall be communicated to all contractors and suppliers to which the procuring entity provides the prequalification documents.*⁷

(4) The procuring entity shall promptly notify all contractors and suppliers submitting applications to prequalify whether or not they have been prequalified and, *after a tender has been accepted,*⁸ shall make available to the general public the names of all contractors and suppliers that have been prequalified. *[Only]*⁹ contractors and suppliers that have been prequalified shall be entitled to submit tenders.

(5) The procuring entity shall upon request communicate to contractors and suppliers that have not been prequalified the grounds therefore, but the procuring entity shall not be required to give reasons to substantiate those grounds.

(6) A procuring entity that has engaged in prequalification proceedings is not precluded from *re-evaluating* at a later stage of the tendering proceedings the qualifications of contractors and suppliers that have been prequalified.¹⁰

³Pursuant to the proposal in A/CN.9/331, para. 45, the words "eligible and" that appeared in the first draft have been deleted. The opening words of the paragraph as it appeared in the first draft have been reformulated in accordance with the suggestion in A/CN.9/331, para. 73, and moved to the second sentence. The word "qualified" at the end of the first sentence and the entire third sentence replace the words "qualified to perform the procurement contract" that appeared in the first draft, in order to clarify the intention that the prequalification proceedings be directed to evaluating the qualifications of contractors and suppliers pursuant to the criteria, requirements and procedures provided for in article 8.

²This subparagraph has been placed within square brackets pursuant to the proposal in A/CN.9/331, para. 74, that the subparagraph be deleted. With respect to the reference to services, see note 8 to article 2.

³Pursuant to the proposal in A/CN.9/331, para. 45, the words "eligibility and" that appeared in the first draft have been deleted. The reference to "written statements" that appeared in the first draft has been deleted pursuant to the proposal in A/CN.9/331, para. 47.

⁴The word "evaluating" replaces the word "assessing" that appeared in the first draft, pursuant to the view reflected in A/CN.9/331, para. 67.

⁵The indicated words have been added in order to be consistent with the changes made to article 24(1) pursuant to A/CN.9/331, para. 120.

⁶This subparagraph has been reformulated pursuant to A/CN.9/331, para. 76, and relocated to paragraph (3 bis).

⁷This paragraph has been added pursuant to A/CN.9/331, para. 76. It is patterned after article 22(1). The paragraph includes requests for clarification of information contained in the prequalification documents relative to the prequalification practices and procedures.

⁸See A/CN.9/331, para. 77.

⁹The word "only" replaces the word "all" that appeared in the first draft, pursuant to the suggestion in A/CN.9/331, para. 72.

¹⁰Pursuant to the proposal in A/CN.9/331, para. 45, the words "eligibility and" that appeared in the first draft have been deleted. The word "re-evaluating" replaces the word "re-assessing" that appeared in the first draft, pursuant to the view reflected in A/CN.9/331, para. 67.

* * *

Section IV. Solicitation documents¹

¹Pursuant to A/CN.9/331, para. 28, references to "procurement documents" in this heading and throughout the text have been changed to "solicitation documents".

* * *

Article 17. *Provision of solicitation documents to contractors and suppliers*

The procuring entity shall provide a set of the *solicitation* documents to contractors and suppliers in accordance with the procedures and requirements specified in the notice of proposed procurement. If prequalification proceedings have been engaged in, the procuring entity shall provide a set of the *solicitation* documents to each contractor and supplier that has been prequalified and that pays the price, if any, charged for those documents.

Article 18. *Contents of solicitation documents*

The *solicitation* documents shall contain [all]¹ information necessary to enable contractors and suppliers to prepare and submit responsive tenders, *[and information concerning the procedures for the opening, examination, comparison and evaluation of tenders,]*² including, but not limited to, the following information:

(a) instructions for preparing tenders;

(b) the criteria and procedures [, conforming with the provisions of article 8,] relative to the evaluation of the qualifications of contractors and suppliers or relative to the reconfirmation of qualifications [pursuant to article 28(8 bis)];³

(c) [this subparagraph has been combined with subparagraph (b), above];

(d) any documentary evidence or other information that must be submitted by contractors and suppliers to

demonstrate their qualifications[, and any requirement imposed pursuant to article 10 that documentary evidence be legalized];⁴

(e) the nature and required technical and quality characteristics of the goods, construction [or services]⁵ to be procured, [in conformity with article 20,]⁶ including, but not limited to, technical specifications, plans, drawings and designs as appropriate; the quantity of the goods; the location where the construction is to be effected; and the desired or required time, if any, when the goods are to be delivered, the construction is to be effected [or the services are to be rendered];⁷

(f) the required terms and conditions of the procurement contract to be entered into as a result of the tendering proceedings[, including, but not limited to, any required terms and conditions concerning the method of pricing to be used in the contract; the extent to which, if at all, taxes, customs duties and similar charges and levies are to be included in the contract price; the allocation between the parties of the risk of higher costs of performing the contract resulting from changes in laws relating to taxes, customs duties and similar charges and levies and from changes in other laws affecting the performance of the contract; the law applicable to the contract; and the means of settling disputes under the contract];⁸

(g) if alternatives to the characteristics of the goods, construction [or services] contractual terms and conditions or other requirements set forth in the solicitation⁹ documents are solicited, a statement to that effect;

(h) if contractors and suppliers are permitted to submit tenders for only a portion of the goods, construction [or services] to be procured, a designation of the portion or portions for which tenders may be submitted;

(i) the manner and, in international tendering proceedings, the currency or currencies in which the tender price is to be formulated and expressed;

(j) [deleted];¹⁰

(k) in international tendering proceedings, the language or languages in which tenders are to be prepared [, in conformity with article 23];⁶

(l) any requirements of the procuring entity with respect to the nature, amount and other principal terms and conditions of any tender security to be provided by contractors and suppliers submitting tenders and of any security for the performance of the procurement contract to be provided by the contractor or supplier that enters into the procurement contract, and with respect to the type of institutions or entities from which such securities will be acceptable, or any choice offered by the procuring entity with respect to the nature, amount or other terms and conditions of the tender security or with respect to the type of institutions or entities;¹¹ [in conformity with article 26];⁶

(m) the manner, place and deadline for the submission of tenders[, in conformity with article 24];⁶

(n) the means by which, pursuant to article 22,¹² contractors and suppliers may seek clarifications of the solicitation documents and the place and time of any meeting of contractors and suppliers [that may be]¹³ convened by the procuring entity;

(n bis) if the procuring entity reserves the right to modify the solicitation documents pursuant to article 22, a statement to that effect;¹⁴

(o) the period of time during which tenders shall be in effect[, in conformity with article 25];⁶

(p) the place, date and time for the opening of tenders[, in conformity with article 27]; the procedures to be followed for opening and examining tenders and the procedures and criteria for evaluating and comparing tenders and for ascertaining the most economic tender [as defined in article 28(7)(c)], including, but not limited to, such factors as how the criteria will be quantified or otherwise applied, the relative weight or other indication of the degree of importance that each criterion will have, the manner in which the criteria will be combined and in which the tenders will be compared in order to ascertain the most economic tender, and any margin of preference that will be applied, its amount and the manner of its application;¹⁵

(q) in international tendering proceedings, the currency that will be used for the purpose of evaluating and comparing tenders [pursuant to article 28(8)]⁶ and either the exchange rate that will be used for the conversion of tenders into that currency or a statement that the rate issued by a specified financial institution prevailing on a specified date will be used;

(r) any other requirements established by the procuring entity in conformity with this Law and the procurement regulations relating to the preparation and submission of tenders and to the tendering proceedings;

(s) [references to:

(i) this Law, the procurement regulations and all other laws and regulations of (this State) directly pertinent to the tendering proceedings; and

(ii) the principal tax, social security, safety, environmental protection, health and labour laws and regulations of (this State) pertinent to the performance of the procurement contract, provided, however, that the omission of any such reference shall not of itself constitute grounds for review under article 36 or give rise to liability on the part of the procuring entity];¹⁶

(t) the name(s) and address(es) of one or more officers or employees of the procuring entity who are authorized to communicate directly with and to receive communications directly from contractors and suppliers in connection with the tendering proceedings, without the intervention of an intermediary;¹⁷

(u) any countertrade commitment to be made by the contractor or supplier;¹⁸

[(v) the acts and decisions of the procuring entity that are subject to approval and the organ or organs that are to give such approval;]¹⁹

(w) the right under article 36 of this Law to seek review of an unlawful act or decision of, or procedure followed by, the procuring entity in relation to the procurement proceedings;¹⁸

[(x) if the procuring entity reserves the right to reject all tenders pursuant to article 29, a statement to that effect;]²⁰

(y) *any formalities that will be required in order for a tender that has been accepted to enter into force, including, where applicable, the signature of a written procurement contract pursuant to article 32.*²¹

¹The word "all" has been placed within square brackets pursuant to the proposal in A/CN.9/331, para. 82, that the word be deleted.

²See A/CN.9/331, para. 83.

³This subparagraph has been reformulated and incorporates subparagraph (c) which appeared in the first draft; the references to article 8 and article 28(8 bis) have been added pursuant to A/CN.9/331, para. 81.

⁴Pursuant to the proposal in A/CN.9/331, para. 45, the words "eligibility and" that appeared in the first draft have been deleted. The reference to "written statements" that appeared in the first draft has been deleted pursuant to the proposal in A/CN.9/331, para. 47. The reference to requirements that documentary evidence be legalized has been added to take account of the change made to article 10, whereby that article would apply only if a requirement of legalization were imposed by the procuring entity, and pursuant to A/CN.9/331, para. 81. It should be deleted if article 10 is not retained.

⁵With respect to the references to services in this subparagraph and elsewhere in the article, see note 8 to article 2.

⁶The reference has been added pursuant to A/CN.9/331, para. 81.

⁷The indicated wording at the end of the subparagraph changes wording used in the first draft in order to be consistent with similar wording in article 28(7)(d).

⁸See A/CN.9/331, paras. 86 and 88. The Working Group may wish to consider whether the added wording is necessary, or whether the reference to required contractual terms and conditions at the beginning of the subparagraph is sufficient.

⁹See note 1 to heading of section IV. This paragraph has been slightly reworded on the initiative of the Secretariat.

¹⁰See A/CN.9/331, para. 89.

¹¹See A/CN.9/331, para. 128. The Working Group may wish to consider whether the point addressed by the added wording is already covered by the subparagraph without that wording, and, therefore, whether the added wording is necessary.

¹²The reference to article 22 corrects a typographical error.

¹³See A/CN.9/331, para. 91.

¹⁴See A/CN.9/331, para. 115, and note 3 to article 22.

¹⁵Pursuant to A/CN.9/331, paras. 92 and 166, the term "most economic tender" replaces the term "most advantageous tender" that appeared in the first draft. The references to articles 27 and 28(7)(c) have been added pursuant to A/CN.9/331, para. 81. The words "and examining tenders and the procedures and criteria for" change wording in the first draft to achieve greater clarity.

¹⁶This subparagraph is a reformulation, pursuant to A/CN.9/331, para. 97, of the subparagraph that appeared in the first draft. It combines two proposals made in A/CN.9/331, para. 96, by requiring references only to the "principal" laws and regulations pertinent to the performance of the contract, instead of requiring exhaustive references, and by negating the possibility of a contractor or supplier claiming review of or compensation for an omission of such a law or regulation. The Working Group might wish to recall the approach agreed upon with respect to article 16(3)(h), the original version of which required the prequalification documents to set forth references to laws and regulations directly pertinent to the prequalification proceedings. In that case, the Working Group decided to delete the requirement and instead to require the procuring entity to be prepared on request to explain the relevant practices and procedures to contractors and suppliers (see A/CN.9/331, para. 76, and the reformulation of the provision in question in article 16(3 bis) of the present draft). The Working Group may wish to consider whether to adopt a similar approach with respect to the present subparagraph.

¹⁷See A/CN.9/331, para. 98.

¹⁸See A/CN.9/331, para. 99. The Working Group may wish to consider whether the point addressed by subparagraph (u) is already covered by subparagraph (f), and whether the requirement in subparagraph (w) is useful or desirable.

¹⁹See A/CN.9/331, paras. 99 and 176. The Working Group may wish to consider whether this requirement is useful or desirable. With respect to the requirement of approval, see note 1 to article 6.

²⁰See A/CN.9/331, para. 177.

²¹See A/CN.9/331, para. 201.

* * *

Article 19. *Charge for solicitation documents*

The procuring entity may charge contractors and suppliers a sum for *solicitation*¹ documents provided to them. The sum shall reflect only the cost of printing the *solicitation* documents and providing them to contractors and suppliers.

¹See note 1 to heading of section IV.

* * *

Article 20. *[Rules concerning description of goods or construction in prequalification documents and solicitation documents; language of prequalification documents and solicitation documents]*¹

(1) Specifications, plans, drawings and designs setting forth the technical or quality characteristics of the goods, construction *[or services]*² to be procured, and requirements concerning testing and test methods, packaging, marking or labelling or conformity certification, and symbols and terminology, shall not be included or used in the prequalification documents or in the *solicitation*³ documents with a view to creating *[unnecessary]*⁴ obstacles to participation by contractors or suppliers in tendering proceedings including, in the case of international procurement proceedings, foreign contractors and suppliers, nor shall such specifications, plans, drawings, designs, requirements, symbols or terminology be included or used which have the effect of creating unnecessary obstacles to such participation.

(2) To the extent possible, specifications, plans, drawings, designs and requirements shall be based on the relevant objective technical and quality characteristics of the goods, construction *[or services]* to be procured. There shall be no requirement of or reference to a particular trade mark, name, patent, design, type, specific origin or producer unless there is no other sufficiently precise or intelligible way of describing the characteristics of the goods or construction to be procured and provided that words such as "or equivalent" are included.

(3)(a) Standardized features, requirements, symbols and terminology relating to the technical and quality characteristics of the goods, construction *[or services]* to be procured shall be used, where available, in formulating the specifications, plans, drawings and designs to be included in the prequalification documents and in the *solicitation* documents.

(b) Standardized trade terms shall be used, where available, in formulating the terms and conditions of the procurement contract to be entered into as a result of the procurement proceedings and in formulating other

relevant aspects of the prequalification documents and of the *solicitation* documents.

(c) [Deleted]⁵

(4) In the case of international procurement proceedings, the prequalification documents and the *solicitation* documents shall be formulated in . . . (each State enacting this Model Law specifies its official language or languages) (and in a language customarily used in international trade). (In the event of a variation or conflict between language versions, the version in the language customarily used in international trade shall prevail.)⁶

⁵See A/CN.9/331, para. 103.

⁶With respect to the references to services in this paragraph and elsewhere in the article, see note 8 to article 2.

³See note 1 to heading of section IV.

⁴See A/CN.9/331, para. 105.

⁵See A/CN.9/331, para. 108.

⁶As explained in paragraph 2 of the commentary to article 20 in the first draft, the reference to a language customarily used in international trade and the final sentence have been placed within round brackets because they need not be adopted by an implementing State whose official language is one customarily used in international trade. Pursuant to the suggestions in A/CN.9/331, para. 109, the formulation of this provision could be altered so as to call upon the implementing State to designate a particular language or languages customarily used in international trade by stating, "each State enacting this Model Law specifies its official language or languages and one or more additional languages customarily used in international trade".

* * *

Article 21. [Deleted]¹

¹See A/CN.9/331, para. 114.

* * *

Article 22. *Clarifications and modifications of solicitation¹ documents*

(1) A contractor or supplier requiring a clarification of the *solicitation* documents shall communicate a request for such clarification to the procuring entity. The procuring entity shall respond promptly to any request for clarification that is received by it prior to the deadline for submission of tenders. The response by the procuring entity, which shall not identify the source of the request, shall be communicated to all contractors and suppliers to which the procuring entity provides the *solicitation* documents.²

(2) At any time prior to the deadline for submission of tenders, the procuring entity may, for any reason, whether at its own initiative or in response to a clarification requested by a contractor or supplier, modify the *solicitation* documents by issuing an addendum thereto, *provided that the right to do so has been specified in the solicitation documents*.³ The addendum shall be communicated promptly to all contractors and suppliers to which the procuring entity sends the *solicitation* documents and shall be binding on them.

(3) Any request for clarification and any response thereto by the procuring entity and any addendum to the *solicitation* documents shall be made in writing or in any other form that preserves a record of the request, response or addendum. [*However, a request for clarification or a response to such a request may be communicated by telephone provided that, immediately thereafter, confirmation of the request or response, as the case may be, is communicated to the recipient of the request or response in writing or by any other means that provides a record of the confirmation.*]⁴

(4) If the procuring entity convenes a meeting of contractors and suppliers, it shall prepare minutes of the meeting containing the requests submitted at the meeting for clarification of the *solicitation* documents, without identifying the sources of the requests, and its responses to those requests. The minutes shall be prepared in writing or in any other form that provides a record of the information contained therein and shall be *provided*⁵ to all contractors and suppliers to which the procuring entity provides the *solicitation* documents.

¹With respect to the reference to solicitation documents in this paragraph and elsewhere in the article, see note 1 to heading of section IV.

²The words "copies of", which appeared at the beginning of this sentence in the first draft, have been deleted so as to avoid an implication that the response must be in writing (see paragraph (3)).

³See A/CN.9/331, para. 115. The Working Group may wish to consider whether this condition is useful or desirable.

⁴See A/CN.9/331, para. 117.

⁵The word "provided" replaces the word "communicated" that appeared in the first draft.

* * *

Section V. Tenders

Article 23. *Language of tenders*

*Tenders may be formulated and submitted in any language in which the solicitation documents have been issued.*¹

¹See A/CN.9/331, para. 119. The effect of this wording is that the procuring entity may not preclude a contractor or supplier from submitting its tender in any language in which the solicitation documents have been issued; but the procuring entity may permit tenders to be submitted in languages other than those in which the solicitation documents have been issued.

* * *

Article 24. *Submission of tenders*

(1) The procuring entity shall fix a specific date and time as the deadline for the submission of tenders. The deadline shall allow sufficient time for contractors and suppliers to prepare and submit their tenders, paying particular regard, in the case of international tendering proceedings, to the time reasonably needed by foreign contractors and suppliers, *and shall take into account the reasonable needs of the procuring entity.*¹

(2) *If the procuring entity issues a clarification or modification of the solicitation documents pursuant to article 22, it shall, prior to the deadline for the submission of tenders, extend the deadline if necessary to afford contractors and suppliers reasonable time to take the clarification or modification into account in their tenders.*²

(2 bis) *The procuring entity may, prior to the deadline for the submission of tenders, extend the deadline if, due to unforeseen circumstances, it is not possible for contractors or suppliers to submit their tenders by the deadline.*³

(2 ter) *Notice of any extension of the deadline shall be given promptly in writing or by any other means that provides a record of the information contained therein to each contractor and supplier to which the procuring entity provides the solicitation documents.*⁴ *[However, notice of an extension of the deadline may be communicated by telephone provided that, immediately thereafter, confirmation of the notice is communicated to the contractors and suppliers in writing or by any other means that provides a record of the confirmation.]*⁵

(3) *A tender received by the procuring entity after the deadline for the submission of tenders shall not be opened or considered and shall be returned to the contractor or supplier that submitted it.*⁶

(4) *Tenders shall be submitted in writing and in sealed envelopes. [However, the procuring entity may give contractors and suppliers the option to submit tenders by any other means that provides a record of the information contained in the tender.]*⁷ *The procuring entity shall provide to the contractor or supplier a receipt showing the date and time when the tender was received.*

¹The word "reasonably" has been added at the initiative of the Secretariat in order to create parallelism between the obligation of the contractors and suppliers and that of the procuring entity. The wording at the end of the sentence has been added pursuant to A/CN.9/331, para. 120.

²See A/CN.9/331, paras. 115 and 121. The Working Group may wish to consider whether making an extension of the deadline mandatory in circumstances that are defined only generally ("if necessary to afford contractors and suppliers a reasonable time") would lead to disputes and litigation, and whether it is preferable to leave it to the judgement of the procuring entity as to whether to extend the deadline, as in the first draft. With respect to the reference to the solicitation documents in this paragraph and elsewhere in the article, see note 1 to heading of section IV.

³This sentence originally appeared as paragraph (2)(a)(ii) of the first draft. It has been placed in a separate paragraph as a consequence of the change made to paragraph (2)(a)(i) of the original draft (currently paragraph (2)).

⁴This sentence appeared as paragraph (2)(b) in the first draft. It has been slightly reworded and placed in a separate paragraph in consequence of the change made to paragraph (2)(a)(i) in the first draft (paragraph (2) in the present draft).

⁵See A/CN.9/331, para. 117.

⁶Pursuant to A/CN.9/331, para. 123, the sentence whereby a tender submitted after the deadline for submission of tenders could be considered if the contractor or supplier was not able to submit its tender on time has been deleted.

⁷As explained in paragraph 4 of the commentary to article 24 in the first draft this sentence has been placed within square brackets in order to invite the Working Group to consider whether or not it should be

included. The sentence will be deleted if not affirmatively acted upon by the Working Group. If the sentence is retained it may be desirable to specify that the availability of the option referred to must be set forth in the solicitation documents.

* * *

Article 25. *Period of effectiveness of tenders; modification and withdrawal of tenders*

(1) *Tenders shall be in effect during the period of time specified in the solicitation documents.*¹ *The period of time shall commence at the deadline for submission of tenders.*

(2)(a) *Prior to the expiry of the period of effectiveness of tenders, the procuring entity may, in exceptional circumstances,*² *request contractors or suppliers to extend the period for an additional specified period of time. A contractor or supplier may refuse the request without forfeiting its tender security, and the effectiveness of its tender will terminate upon the expiry of the unextended period of effectiveness.*³ *The request and the responses thereto shall be made in writing or by any other means that provides a record of the information contained therein. [However, a request or a response may be communicated by telephone provided that, immediately thereafter, confirmation of the request or response is communicated to the recipient in writing or by any other means that provides a record of the confirmation.]*⁴

(b) *The procuring entity shall*⁵ *require contractors and suppliers that agree to the extension to extend or to procure an extension of the period of effectiveness of tender securities provided by them or, if it is not possible to do so, to provide new tender securities, to cover the extended period of effectiveness of their tenders.*

(3) *[A contractor or supplier may modify or withdraw its tender prior to the deadline for the submission of tenders by communicating the modification or a notice of withdrawal to the procuring entity in writing or by any other means that provides a record of the information contained therein. The modification or notice of withdrawal is effective if it is received by the procuring entity prior to the deadline for submission of tenders.]*⁶

¹See note 1 to heading of section IV.

²See A/CN.9/331, para. 124. The Working Group may wish to consider whether the potential for disputes and litigation arising from the inclusion of this condition outweighs its usefulness.

³See A/CN.9/331, para. 124.

⁴See A/CN.9/331, para. 117.

⁵The word "shall" replaces the word "may" that appeared in the first draft, pursuant to A/CN.9/331, para. 125. The Working Group may wish to consider whether it is preferable to leave to the judgement of the procuring entity the question of whether or not tender securities are to be extended.

⁶This paragraph has been slightly reworded on the initiative of the Secretariat, and placed within square brackets in view of the differing views set forth in A/CN.9/331, para. 126. The paragraph will be retained in its present form unless the Working Group decides otherwise.

* * *

Section VI. Tender securities

Article 26. Tender securities

(1) If the procuring entity requires contractors and suppliers submitting tenders to provide a tender security:

(a) the requirement shall apply to all such contractors and suppliers;

(b) in international tendering proceedings, a contractor or supplier shall not be precluded from providing a tender security issued by a foreign institution or entity, if the tender security and the institution or entity otherwise conform to lawful requirements set forth in the solicitation documents, unless the issuance of the security by the institution or entity would be in violation of a law of (this State) relating to the issuance of securities of the type in question or relating to the transaction of business in (this State) by the institution or entity;¹

(c) the solicitation documents may stipulate that the institution or entity issuing the tender security must be acceptable to the procuring entity;²

[(d) the procuring entity shall require, in the solicitation documents, that the tender security include provisions entitling the procuring entity to claim the amount of the security if the contractor or supplier that supplied it:

- (i) withdraws or modifies its tender contrary to the provisions of article 25;
- (ii) does not accept a correction of an arithmetical error in its tender and its tender is rejected pursuant to article 28(2)(b); or
- (iii) fails to sign a procurement contract if required by the procuring entity to do so or fails to provide a required security for the performance of the contract, if its tender has been accepted.]³

(2) The procuring entity shall make no claim to the amount of the tender security, and shall, without delay, return or procure the return of the tender security to the contractor or supplier that supplied it, after the earliest to occur of:

- (a) the expiry of the tender security;
- (b) the entry into force of a procurement contract and the provision of a security for the performance of the contract, if such a security is required;
- (c) the termination of the tendering proceedings without the entry into force of a procurement contract; or⁴
- (d) the permitted withdrawal of the tender in connection with which the tender security was supplied.⁵

¹See A/CN.9/331, paras. 129 and 131. Some changes in wording have been made in order to achieve greater clarity.

²See A/CN.9/331, para. 129. Although the Working Group stated that the substance of this provision should be incorporated into a reformulated subparagraph (b), it has been added as a separate subparagraph in order to enable the procuring entity in all cases (i.e., even in cases of wholly domestic procurement) to impose the condition that the issuer of the tender security must be acceptable to the procuring entity.

³See A/CN.9/331, para. 135. The Working Group may wish to consider whether it is preferable to leave to the judgement of the procuring entity what terms the tender security should contain with respect to the circumstances in which the security can be claimed.

⁴This provision replaces the provision that appeared in the first draft, which read, "the rejection by the procuring entity of all tenders pursuant to article 28(2) or (3) or article 29". The present formulation encompasses the formulation in the first draft, and also takes into account the proposal in A/CN.9/331, para. 133, that reference be made to the time when the tendering proceedings terminated.

⁵See A/CN.9/331, para. 133.

* * *

Section VII. Opening, examination, evaluation and comparison of tenders

Article 27. Opening of tenders

(1) Tenders shall be opened at the time specified in the solicitation documents as the deadline for the submission of tenders, or at any extension of the deadline, at the place and in accordance with the procedures specified in the solicitation documents.¹

(2) All contractors and suppliers that have submitted tenders or their representatives shall be permitted to be present at the opening of tenders.

(3) The name and address of each contractor or supplier whose tender is opened and the tender price shall be announced to those persons present at the opening of tenders[, communicated to all contractors and suppliers that have submitted tenders but that are not present or represented at the opening of tenders.] [and recorded immediately in the record of the tendering proceedings required by article 33].²

¹See A/CN.9/331, para. 137, and note 1 to the heading of section IV.

²These additions have been made pursuant to the suggestion and proposal in A/CN.9/331, para. 142. The Working Group may wish to consider whether the requirement that the information be communicated to absent contractors and suppliers is useful or desirable.

* * *

Article 28. Examination, evaluation and comparison of tenders

(1)(a) To assist in the examination, evaluation and comparison of tenders, the procuring entity may ask contractors and suppliers for clarifications of their tenders. Any request for clarification and any response to such a request shall be in writing or in any other form that provides a record of the information contained therein. [However, a request or response may be communicated by telephone provided that, immediately thereafter, confirmation of the request or response is communicated to the recipient in writing or by any other means that provides a record of the request or response.]¹ No change in the tender price or other matter of substance in the tender shall be sought, offered or permitted, except as provided in subparagraph (b).

[(b) The procuring entity shall correct purely arithmetical errors apparent on the face of a tender.]²

(2) The procuring entity shall reject a tender:

- (a) if the contractor or supplier that submitted the tender is not qualified, subject to article 8(3);³

(b) if the contractor or supplier submitted the tender does not accept a correction of an arithmetical error made pursuant to paragraph (1)(b);

(c) if the tender is not responsive;⁴

[(d) if the tender is received by the procuring entity after the deadline for the submission of tenders].⁵

(3) [Subject to approval,] the procuring entity may reject a tender if the contractor or supplier that submitted it offers, gives or agrees to give to any officer or employee or former officer or employee of the procuring entity a gratuity, whether or not in the form of money, an offer of employment or any other thing or service of value, as an inducement with respect to an act or decision of, or procedure followed by, the procuring entity in connection with the tendering proceedings. The rejection of the tender and the reasons therefor shall be recorded in the record of the tendering proceedings.⁶

(4) The procuring entity may regard a tender as responsive even if it contains minor deviations that do not materially alter or depart from the characteristics, terms, conditions and other requirements set forth in the solicitation documents. Those permitted deviations shall be quantified and appropriately taken account of in the evaluation and comparison of tenders.⁷

(5) [deleted]⁸

(6) [deleted]⁹

(7)(a) The procuring entity shall evaluate and compare tenders that have not been rejected pursuant to paragraph (2) or (3) in order to ascertain the most economic tender, as defined in subparagraph (c),¹⁰ in accordance with the procedures and criteria set forth in the solicitation documents. No criterion shall be used that has not been set forth in the solicitation documents.¹¹

(b) [deleted]¹²

(c) The most economic tender shall be either:

- (i) the tender with the lowest tender price, subject to any margin of preference applied pursuant to subparagraph (e) of this paragraph, or
- (ii) the lowest evaluated tender,¹³ which shall be ascertained on the basis of objective and quantifiable criteria, to the extent possible, including, in addition to the tender price, subject to any margin of preference applied pursuant to subparagraph (e) of this paragraph, such criteria as: the costs of operating, maintaining and repairing the goods or construction over its expected useful life; the functional characteristics of the goods, construction [or services]; the efficiency and productivity of the goods, construction [or services]; the time for delivery of the goods, completion of the construction [or rendering of the services]; the terms of payment; and the terms and conditions of the quality guarantee in respect of the goods, construction [or services].¹⁴

[(d) In addition to criteria of the nature referred to in subparagraph (c)(ii) of this paragraph, the procuring entity may apply criteria concerning the effect of the tender on

the balance of payments or the foreign exchange reserves of (this State); the extent to which enterprises, personnel, industries, regions or economic sectors in (this State) would benefit economically as a result of the tender; or the extent to which technological, production, operational, managerial or similar information or skills would be acquired by enterprises or personnel in (this State). To the extent possible, such criteria shall be expressed in the solicitation documents in objective and quantifiable terms.]¹⁵

(e) In evaluating and comparing tenders, a procuring entity may grant a margin of preference for the benefit of tenders for construction by domestic contractors and suppliers or for the benefit of tenders for domestically produced goods. The margin of preference shall be applied by deducting from the tender prices of all tenders, other than those that are to benefit from the margin of preference, import duties and taxes and sales and similar taxes levied in connection with the supply of the goods [or services] or with the construction, and adding to the resulting tender prices the amount of the margin of preference provided for in the procurement regulations or the actual import duty, whichever is less.¹⁶

(8) When tender prices are expressed in two or more currencies, the tender prices [of all tenders] shall be converted to [the same] currency for the purpose of evaluating and comparing tenders.¹⁷

(8 bis) Where the procuring entity has engaged in prequalification proceedings pursuant to article 16 it shall, and when it has not engaged in prequalification proceedings it may, require the contractor or supplier submitting the tender that has been found to be the most economic tender pursuant to article 28(7)(c) to reconfirm its qualifications in accordance with criteria and procedures conforming to the provisions of article 8. The criteria and procedures to be used for such reconfirmation shall be set forth in the solicitation documents. Where prequalification proceedings have been engaged in, the criteria shall be the same as those used in the prequalification proceedings.¹⁸

(9) Information relating to the examination, clarification, evaluation and comparison of tenders shall not be disclosed to contractors or suppliers or to any other person not officially involved in the examination, evaluation or comparison of tenders or involved¹⁹ in the decision of which tender should be accepted, except as provided in article 33(2).

(10) [deleted]²⁰

⁴See A/CN.9/331, para. 117.

⁵See A/CN.9/331, para. 145. This subparagraph has been placed within square brackets in view of the discussion in A/CN.9/331, para. 146. The subparagraph will be retained in its present form unless the Working Group decides otherwise. The sentence in the first draft which read: "Any such correction shall be binding on the contractor or supplier that submitted the tender if accepted by that contractor or supplier" has been deleted on the initiative of the Secretariat as the point seemed to be covered by paragraph (2)(b).

⁶Pursuant to the proposal in A/CN.9/331, para. 45, the reference to eligibility that appeared in the first draft has been deleted. The reference to article 8(3) corrects a typographical error. The square brackets surrounding that reference in the first draft have been removed in view of the decision to retain article 8(3) (see note 14 to article 8).

⁴The reference to paragraph (6) that appeared in the first draft has been deleted in view of the deletion of paragraph (6). The reference to article 29(1)(a) that appeared in the first draft was a typographical error and the reference should have been article 30(1)(a). The reference has been deleted in view of the deletion of article 30(1)(a).

⁵This subparagraph has been added pursuant to A/CN.9/331, para. 150. The Working Group may wish to consider whether it is preferable to require the procuring entity to return a late tender unopened, as currently provided in article 24(3), rather than to retain the tender and reject it under article 28(2). If so, the present subparagraph should be deleted.

⁶See A/CN.9/331, para. 152. With respect to the requirement of approval, see note 1 to article 6.

⁷Pursuant to A/CN.9/331, para. 156, the first sentence of this subparagraph has been relocated to article 2(j), the remainder of the subparagraph has been slightly reworded, and subparagraph (b) has been deleted.

⁸See A/CN.9/331, para. 159.

⁹See A/CN.9/331, para. 164.

¹⁰Pursuant to A/CN.9/331, paras. 92 and 166, the term "most economic tender" replaces the term "most advantageous tender" that appeared in the first draft, and the reference to subparagraph (c) has been added.

¹¹See A/CN.9/331, para. 169.

¹²See A/CN.9/331, para. 167.

¹³The term "lowest evaluated tender" replaces the term "most economically advantageous tender" that appeared in the first draft, as a consequence of the change of the term "most advantageous tender" to "most economic tender".

¹⁴The last clause of this subparagraph as it appeared in the first draft has been deleted pursuant to A/CN.9/331, para. 168. With respect to the references to services in this subparagraph and elsewhere in the article, see note 8 to article 2.

¹⁵See A/CN.9/331, para. 172.

¹⁶See A/CN.9/331, para. 173. The approach reflected in the indicated wording conforms with that followed by several international financing institutions. The Working Group may wish to consider whether the matters addressed by the wording would be better dealt with in the procurement regulations.

¹⁷See A/CN.9/331, para. 174.

¹⁸See A/CN.9/331, paras. 70, 73 and 78. With reference to the statement in A/CN.9/331, para. 78, that the provision should indicate what was to occur if the qualifications of the contractor or supplier were not reconfirmed, it seems clear that the tender would have to be rejected under article 28(2)(a), and that the provisions of article 7(2)(b) would apply. The Working Group may wish to consider whether it is necessary for that information to be added to the provision.

¹⁹Added on the initiative of the Secretariat to achieve greater clarity.

²⁰See A/CN.9/331, para. 176.

* * *

Article 29. Rejection of all tenders

(1) [Subject to approval,] [and if so specified in the solicitation documents,] the procuring entity may, at any time prior to the acceptance of a tender, reject all tenders for any reason other than for the sole purpose of engaging in competitive negotiation proceedings and other than any fraudulent purpose.¹

(1 bis) If the procuring entity rejects all tenders for the reason that the tender prices of all tenders substantially exceed an estimated price established by the procuring entity prior to the commencement of the tendering proceedings, it may either engage in new tendering proceedings on the basis of modified specifications concerning the technical or quality characteristics of the goods, construction [or services] to be procured, or [, subject to approval,] engage in competitive negotiation proceedings

with the qualified contractor or supplier that submitted the most economic tender as defined in article 28(7)(c).²

(2) The procuring entity shall incur no liability, solely by virtue of its invoking paragraph (1), towards contractors and suppliers that have submitted tenders. *The procuring entity shall upon request communicate to any contractor or supplier that submitted a tender the grounds for its rejection of all tenders, but shall not be required to justify those grounds.*³

(3) Notice of the rejection of all tenders pursuant to this article shall be given promptly, in writing or by any other means that provides a record of the information contained therein, to all contractors and suppliers that submitted tenders. *[However, the notice may be communicated by telephone provided that, immediately thereafter, confirmation of the notice is communicated in writing or by any other means that provides a record of the confirmation.]*⁴

¹See A/CN.9/331, paras. 177, 180, and 182. With respect to the requirement of approval in this paragraph and elsewhere in the article, see note 1 to article 6. The intent of the word "sole" is to recognize that, pursuant to paragraph (1 bis) (added pursuant to A/CN.9/331, para. 182), the procuring entity may reject all tenders for the reason that they all exceed an estimated price, and that in such a case it may engage in competitive negotiation proceedings. The Working Group may wish to consider whether it is useful or desirable to require the right to reject all tenders to be reserved in the solicitation documents. Minor changes in drafting have been made on the initiative of the Secretariat in order to improve the clarity of the paragraph.

²See A/CN.9/331, para. 182. The Working Group may wish to note that the case where all tenders are rejected because they exceed an estimated price is the only case that is subject to the special provisions set forth in this paragraph. In all other cases where all tenders are rejected, the manner in which the procuring entity may proceed is governed by article 7; namely, it may commence new tendering proceedings (without necessarily having to modify the specifications) or, in the cases mentioned in article 7(2), it may engage in competitive negotiation proceedings. The Working Group may wish to consider whether the situation envisaged by this paragraph should also be left to be governed by the provisions of article 7. In addition, in connection with the issue of estimated prices, the Working Group may wish to recall its disapproval of maximum prices, minimum prices and a range of prices (A/CN.9/331, paras. 89 and 182), and consider whether reference in the Model Law to estimated prices is desirable.

³See A/CN.9/331, para. 181.

⁴See A/CN.9/331, para. 117.

* * *

Article 30. Negotiations with contractors and suppliers

No negotiations shall take place between the procuring entity and a contractor or supplier with respect to a tender submitted by the contractor or supplier, *except as provided in article 29(1 bis) and article 31(4).*¹

¹Paragraphs (1)(a) and (b) and paragraph (2) have been deleted pursuant to A/CN.9/331, paras. 182 and 183. The prevailing view of the Working Group, expressed in A/CN.9/331, para. 184, was that the *chapeau* of paragraph (1) should be retained but placed elsewhere in the Model Law. The *chapeau* has been retained in article 30 in the present draft as no other location was found to be appropriate. The final words have been added in view of the addition of paragraph (1 bis) in article 29 and of the reference in article 31(4) to negotiations.

* * *

Section VIII. Two-stage tendering proceedings¹

¹See A/CN.9/331, para. 186.

* * *

Article 31. Two-stage tendering proceedings

(1) [Subject to approval,]¹ the procuring entity may employ the procedures provided for in this article where:

(a) *instead of formulating detailed specifications for the goods, construction [or services], the procuring entity seeks proposals from contractors and suppliers in order to obtain the most advanced or the most appropriate technology or otherwise to obtain the most satisfactory solution to its procurement needs;*² or

(b) *due to the nature of the goods, construction [or services], the procuring entity is unable to formulate detailed technical specifications.*²

(2) The provisions of chapter II of this Law shall apply to tendering proceedings in which the procedures provided for in the present article are employed except to the extent those provisions are derogated from in the present article.

(3) *The solicitation documents, which shall be prepared in conformity with articles 18 and 20 of this Law, shall call upon contractors and suppliers to submit initial tenders containing their proposals without a tender price. The solicitation documents may solicit proposals relating to the technical, quality or other characteristics of the goods, construction [or services] as well as to contractual terms and conditions of their supply.*³

(4) The procuring entity may engage in negotiations⁴ with any contractor or supplier whose tender has not been rejected pursuant to article 28(2) or (3) or article 29 concerning any aspect of its tender.

(5) The procuring entity shall invite contractors and suppliers whose tenders have not been rejected to submit final tenders with prices. *The procuring entity may delete or modify any aspect, set forth in the solicitation documents, of the technical or quality characteristics of the goods, construction [or services] to be procured, [and any criterion set forth in those documents for evaluating and comparing tenders and for ascertaining the most economic tender.] and may add new characteristics [or criteria] that conform with this Law. Any such deletion, modification or addition shall be communicated to contractors and suppliers in the invitation to submit final tenders.*⁵ A contractor or supplier not wishing to submit a final tender may withdraw from the tendering proceedings [without forfeiting its tender security].⁶ The final tenders shall be evaluated and compared in order to ascertain the most economic tender as defined in article 28(7)(c).⁷

(6) The procuring entity shall include in the record⁸ required under article 33 a statement of the circumstances on which it relied in invoking paragraph (1) of this article, specifying the relevant facts.

¹See note 1 to article 6.

²See A/CN.9/331, paras. 185 and 188. With respect to the references to services in this paragraph and elsewhere in the article, see note 8 to article 2.

³The reference to articles 18 and 20 has been included pursuant to A/CN.9/331, para. 189. The second sentence of the paragraph has been added pursuant to A/CN.9/331, para. 188. With respect to the reference to solicitation documents, see note 1 to heading of section IV.

⁴See A/CN.9/331, para. 191. The word "article" has been added to achieve greater clarity.

⁵See A/CN.9/331, paras. 190 and 192.

⁶The reference to the tender security has been placed within square brackets pursuant to the proposal in A/CN.9/331, para. 192.

⁷Pursuant to A/CN.9/331, paras. 92 and 166, the term "most economic tender" replaces the term "most advantageous tender" that appeared in the first draft, and the reference to article 28(7)(c) has been added pursuant to A/CN.9/331, para. 189.

⁸Pursuant to A/CN.9/331, para. 207, the word "record" replaces the word "minutes" that appeared in the first draft.

* * *

Section IX. Acceptance of tender and entry into force of procurement contract; record of tendering proceedings¹

Article 32. Acceptance of tender and entry into force of procurement contract

(1) The tender that has been ascertained to be the most economic tender pursuant to article 28(7)(c) shall be accepted.² However, if the contractor or supplier submitting that tender is required to reconfirm its qualifications pursuant to article 28(8 bis), its tender shall not be accepted unless its qualifications are reconfirmed.³ Notice of acceptance of the tender shall be given promptly to the contractor or supplier submitting the tender.

[(2) Except as provided in paragraph (3)(b),⁴ a procurement contract in accordance with the terms and conditions of the accepted tender enters into force when the notice referred to in paragraph (1) is dispatched to the contractor or supplier that submitted the tender, provided that it is dispatched while the tender is in force and effect.]⁵

[(3)(a) Notwithstanding the provisions of paragraph (2), the notice referred to in paragraph (1) may require the contractor or supplier whose tender has been accepted to sign a written procurement contract conforming to the tender. [When the notice, or the applicable law relative to the formation of contracts, requires the signature of a written contract,]⁴ the procuring entity and⁶ the contractor or supplier shall sign the procurement contract within a reasonable period of time after the notice is dispatched to the contractor or supplier.

(b) Where a written procurement contract is required to be signed pursuant to paragraph (3)(a),⁴ the procurement contract enters into force when the contract is signed by the contractor or supplier and by the procuring entity. Between the time when the notice referred to in paragraph (1) is dispatched to the contractor or supplier and the entry into force of the procurement contract:

(i) *neither the procuring entity nor the contractor or supplier shall take any action that would defeat the object or purpose of the contract or that would interfere⁶ with the entry into force*

of the procurement contract or with its performance;

- (ii) *the procuring entity and the contractor or supplier shall inform each other of any circumstance of which they are aware that could interfere with the entry into force of the procurement contract or its performance;*⁶
- (iii) *the procuring entity and the contractor or supplier shall cooperate with each other as necessary in order for the procurement contract to enter into force.*⁵

[(4) If the contractor or supplier whose tender has been accepted fails to sign a written procurement contract, if required to do so, or fails to provide any required security for the performance of the contract, the tender that is ascertained to be the next most *economic tender pursuant to article 28(7)(c)*⁷ and that is in force may be accepted.⁸ The notice provided for in paragraph (1) shall be given to the contractor or supplier that submitted that tender.]⁹

(5) Upon the entry into force of the procurement contract and the provision by the contractor or supplier of a security for the performance of the contract, if required, notice of the procurement contract shall be given to other contractors and suppliers, specifying the name and address of the contractor or supplier that has entered into the contract and the price of the contract.

(6)(a) The notices referred to in this article may be given in writing or by any other means that provides a record of the information contained therein. [*However, the notices may be communicated by telephone provided that, immediately thereafter, confirmation of the notice is communicated in writing or by any other means that provides a record of the confirmation.*]¹⁰

(b) The notice under paragraph (1) is "dispatched" when it is properly addressed or otherwise directed and transmitted to the contractor or supplier, or conveyed to an appropriate authority for transmission to the contractor or supplier, by a mode authorized by paragraph (6)(a).¹¹

¹Pursuant to A/CN.9/331, para. 207, the term "minutes of tendering proceedings" has been changed to "record of tendering proceedings".

²Pursuant to A/CN.9/331, para. 194, the words "subject to approval" have been deleted from this paragraph and from paragraph (4) (see, also, note 1 to article 6). Pursuant to A/CN.9/331, paras. 92 and 166, the term "most economic tender" replaces the term "most advantageous tender" that appeared in the first draft, and the reference to article 28(7)(c) has been added.

³See A/CN.9/331, paras. 70 and 78.

⁴See A/CN.9/331, para. 196.

⁵Paragraphs (2) and (3) have been placed within square brackets in view of the differing views reflected in A/CN.9/331, paras. 197 to 200. They will be retained in their present form unless the Working Group decides otherwise. Pursuant to A/CN.9/331, para. 195, the references to receipt of the notice of acceptance of the tender have been deleted. It will be noted that the "dispatch" approach differs from the approach in the United Nations Convention on Contracts for the International Sale of Goods, art. 24. See the discussion of this point in the Working Group note following paragraph 1 of the commentary to article 32 in the first draft.

⁶See A/CN.9/331, paras. 202, 203 and 206.

⁷Pursuant to A/CN.9/331, paras. 92 and 166, the term "most economic tender" replaces the term "most advantageous tender" that appeared in the first draft, and the reference to article 28(7)(c) has been added.

⁸Pursuant to A/CN.9/331, para. 194, the words "subject to approval" have been deleted (see, also, note 1 to article 6.). The phrase "in force and effect" that appeared in the first draft has been changed to "in force".

⁹Paragraph (4) has been placed within square brackets in the light of the differing views reflected in A/CN.9/331, para. 205. The paragraph will be retained in its present form unless the Working Group decides otherwise.

¹⁰See A/CN.9/331, para. 117.

¹¹Pursuant to A/CN.9/331, para. 195, alternative 2 of paragraph 6(b) has been deleted.

* * *

Article 33. *Record of tendering proceedings*¹

(1) The procuring entity shall prepare a *record* of the tendering proceedings, including the opening, examination, evaluation and comparison of tenders. The *record* shall contain a brief description of the goods or construction to be procured, the names and addresses of contractors and suppliers that submitted tenders; information relative to the qualifications, or lack thereof, of those contractors and suppliers;² the price and a summary of the other principal terms and conditions of each tender and of the procurement contract; a summary of the evaluation and comparison of tenders; *the information required by article 28(3), if a tender was rejected pursuant to that provision;*³ if all tenders were rejected pursuant to article 29, a statement to that effect; and, where applicable, the statement required by article 31(6).

(2) The *record* of the tendering proceedings shall be made available for inspection by *any person*⁴ after [a procurement contract has entered into force and the contractor or supplier has supplied a security for the performance of the contract, if required,] *[a tender has been accepted]*⁵ or after tendering proceedings have been terminated without resulting in a procurement contract. However:

(a) *information shall not be disclosed if its disclosure would be contrary to law, would impede law enforcement, would not be in the public interest, would prejudice legitimate commercial interests of the parties or would inhibit fair competition;*⁶

(b) *information relating to the examination, evaluation and comparison of tenders[, and tender prices,] shall not be disclosed.*⁷

¹Pursuant to A/CN.9/331, para. 207, the term "minutes of tendering proceedings" that appeared in the first draft has been changed to "record of tendering proceedings" in the title and text of article 33.

²Pursuant to A/CN.9/331, para. 45, the words "eligibility and" that appeared in the first draft have been deleted.

³See A/CN.9/331, para. 152.

⁴Pursuant to A/CN.9/331, para. 209, the words "any person" replace the words "the general public" that appeared in the first draft.

⁵Pursuant to the proposal in A/CN.9/331, para. 212, two alternatives are presented within square brackets for the consideration of the Working Group. The first alternative, which appeared in the first draft, is that the record of the tendering proceedings is to be disclosed after the procurement contract has entered into force and the contractor or supplier supplies a performance security. The second alternative is that disclosure must take place when a tender has been accepted. The time when a tender is accepted would seem to be the earliest time when disclosure of the record could be required, since prior to that time the tendering proceedings would still be in progress and the record would not necessarily have been prepared or completed. It will also be noted that, pursuant to article 32, the

acceptance of the tender and the entry into force of the procurement contract will occur simultaneously, except where the signature of a written contract is required. Unless the Working Group decides otherwise, the first alternative will be retained.

⁶See A/CN.9/331, para. 210.

⁷See A/CN.9/331, para. 211. The Working Group may wish to consider whether disclosure of this information, and in particular the tender prices (reference to which has been set forth within square brackets), is important in order to assure participants in the tendering proceedings, and the public in general, that the procurement law and the procurement regulations have been complied with, and in order to enable an aggrieved contractor or supplier to seek review of acts or decisions of, or procedures followed by, the procuring entity. Articles 33, 34(4) and 35 deal with analogous matters. Once the text of those provisions is settled, they might be consolidated into a single article.

* * *

Chapter III. Procurement other than by means of tendering proceedings

Article 34. *Competitive negotiation proceedings*

(1) In competitive negotiation proceedings, the procuring entity shall engage in negotiations with a sufficient number of contractors and suppliers to ensure effective competition.¹

(2) Any requirements, guidelines, documents or other information relative to the negotiations that are communicated by the procuring entity to a contractor or supplier shall be communicated on an equal basis to all other contractors and suppliers engaging in negotiations with the procuring entity relative to the procurement.²

(3) Negotiations between the procuring entity and a contractor or supplier shall be confidential, and, except as provided in paragraph (4), one party to those negotiations shall not reveal or disclose to any third person any documentation or information relating to those negotiations without the consent of the other party.

(4)(a) The procuring entity shall prepare a record of the competitive negotiation proceedings. The record shall contain the names and addresses of contractors and suppliers with which the procuring entity has engaged in

negotiations; the price and a summary of the other principal terms and conditions of the procurement contract; if the proceedings did not result in a procurement contract, a statement of the reasons therefor; and the statement and facts required by article 7(5).³

(b) The record of the competitive negotiation proceedings shall be made available for inspection by any person after a procurement contract has entered into force, except that information shall not be disclosed if its disclosure would be contrary to law, would impede law enforcement, would not be in the public interest, would prejudice legitimate commercial interests of the parties or would inhibit fair competition.³

¹The final phrase of this paragraph, which appeared in the first draft, has been deleted pursuant to A/CN.9/331, para. 216.

²The final phrase of this paragraph, which appeared in the first draft, has been deleted pursuant to A/CN.9/331, para. 217.

³See A/CN.9/331, para. 218.

* * *

Article 35. *Record of single source procurement*

(1) The procuring entity shall prepare a record of the single source procurement. The record shall contain the name and address of the contractor or supplier from which the procuring entity procured the goods or construction, the price and a summary of the other principal terms and conditions of the procurement contract and the statement and facts required by article 7(5).

(2) The record shall be made available for inspection by any person after the procurement contract has entered into force; provided, however, that information shall not be disclosed if its disclosure would be contrary to law, would impede law enforcement, would not be in the public interest, would prejudice legitimate commercial interests of the parties or would inhibit fair competition.¹

¹See A/CN.9/331, para. 220.

* * *

III. GUARANTEES AND STAND-BY LETTERS OF CREDIT

A. Report of the Working Group on International Contract Practices on the work of its fourteenth session

(Vienna, 3-14 September 1990) (A/CN.9/342) [Original: English]

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INTRODUCTION

1. Pursuant to a decision taken by the Commission at its twenty-first session,¹ the Working Group on International Contract Practices devoted its twelfth session to a review of the draft Uniform Rules on Guarantees being prepared by the International Chamber of Commerce and to an examination of the desirability and feasibility of any future work relating to greater uniformity at the statutory law level in respect of guarantees and stand-by letters of credit. The Working Group recommended that work be initiated on the preparation of a uniform law, whether in the form of a model law or in the form of a convention.

2. The Commission, at its twenty-second session, accepted the recommendation of the Working Group that work on a uniform law should be undertaken and entrusted this task to the Working Group.²

3. At its thirteenth session, the Working Group commenced its work by considering possible issues of a uniform law as discussed in a note by the Secretariat (A/CN.9/WG.II/WP.65). Those issues related to the substantive scope of the uniform law, party autonomy and its limits, and possible rules of interpretation. The Working Group also engaged in a preliminary exchange of views on issues relating to the form and time of establishment of the guarantee or stand-by letter of credit. The Working Group requested the Secretariat to submit to its fourteenth session

¹Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), para. 18.

²Ibid., Forty-fourth Session, Supplement No. 17 (A/44/17), para. 244.

a first draft set of articles, with possible variants, on the above issues as well as a note discussing other possible issues to be covered by the uniform law.

4. The Working Group, which was composed of all States members of the Commission, held its fourteenth session at Vienna, from 3 to 14 September 1990. The session was attended by representatives of the following States members of the Working Group: Argentina, Cameroon, Canada, Chile, China, Cuba, Czechoslovakia, Egypt, France, Germany, Federal Republic of, Hungary, India, Iran (Islamic Republic of), Japan, Mexico, Morocco, Netherlands, Nigeria, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, and United States of America.

5. The session was attended by observers from the following States: Austria, Bolivia, Finland, German Democratic Republic, Pakistan, Panama, Poland, Saudi Arabia, Sweden, Switzerland, Thailand, Turkey and Venezuela.

6. The session was attended by observers from the following international organizations: Asian-African Legal Consultative Committee (AALCC), Commission of the European Communities (CEC), Hague Conference on Private International Law, European Banking Federation, International Chamber of Commerce (ICC).

7. The Working Group elected the following officers:

Chairman: Mr. J. Gauthier (Canada)

Rapporteur: Mr. J. C. Treviño (Mexico)

8. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.66), a note by the Secretariat containing a first draft of general provisions and an article on establishment (A/CN.9/WG.II/WP.67), and a note by the Secretariat discussing further issues of a uniform law: amendment, transfer, expiry, obligations of guarantor, liability and exemption (A/CN.9/WG.II/WP.68).

9. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a uniform law on guarantees and stand-by letters of credit.
4. Other business.
5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

10. The Working Group examined draft articles 1 to 7 of the uniform law prepared by the Secretariat (A/CN.9/WG.II/WP.67). The deliberations and conclusions of the Working Group are set forth below in chapter II. The Secretariat was requested to prepare, on the basis of those conclusions, a revised draft of articles 1 to 7 of the uniform law.

11. The Working Group then considered the issues discussed in the note by the Secretariat relating to amendment, transfer, expiry, and obligations of guarantor (A/CN.9/WG.II/WP.68). The deliberations and conclusions of

the Working Group are set forth below in chapter III. The Secretariat was requested to prepare, on the basis of those conclusions, a first draft of articles on the issues discussed.

12. It was noted that the Secretariat would submit to the Working Group at its next session a note on further issues to be covered by the uniform law, including fraud and other objections to payment, injunctions and other court measures, conflict of laws and jurisdiction.

II. CONSIDERATION OF FIRST DRAFT OF GENERAL PROVISIONS AND ARTICLE ON ESTABLISHMENT

13. The Working Group considered draft articles 1 to 7 as set forth with explanatory remarks in a note by the Secretariat (A/CN.9/WG.II/WP.67).

Article 1. Scope of application

14. The text of draft article 1 as considered by the Working Group was as follows:

"This Law applies to an international guaranty letter [issued in this State]."

15. In connection with the discussion on the scope of application of the uniform law, general comments were made on the purpose of the uniform law and on the policies that should guide its preparation. It was pointed out, for example, that the operative rules of the uniform law should be based on actual and sound practice with due regard for modern technological developments. Since current practices differed, the uniform law should help to validate and provide a better link between the different practices. The uniform law should focus on those issues that could not effectively be dealt with at the contractual level, whether by individual stipulations of the parties or by uniform rules such as those prepared by the International Chamber of Commerce (ICC).

16. As regards the wording between square brackets, it was suggested that a more objective criterion should be found (e.g., place of business of guarantor) and that the parties' freedom to choose another law should be clearly stated. The Working Group was agreed that it would be premature at this stage to decide on the territorial scope of application of the uniform law. It was pointed out that the decision would in some respects depend on whether the uniform law would eventually be adopted in the form of a convention or in the form of a model law. In the latter case the question could be settled by rules on conflict of laws that would probably be included in the model law.

Article 2. Guaranty letter

17. The text of draft article 2 as considered by the Working Group was as follows:

"A guaranty letter, whether or not named guaranty letter, guarantee, bond, indemnity or stand-by letter of credit, is an independent undertaking, given by a bank or other institution or person ('guarantor') [at the

request of its customer ('principal') or on the instruction of another bank, institution or person ('instructing party') acting at the request of its customer ('principal') [, whether or not so requested or instructed by another institution or person], to pay to another person ('beneficiary') a certain or determinable amount of a specified currency [, unit of account or other item of value] in conformity with the terms of the undertaking."

18. The view was expressed that this article, despite the use of the term "guaranty letter" and the illustrative listing of guarantee undertakings, could be read as covering not only guarantees and stand-by letters of credit but also commercial letters of credit and even other credits and financial promises. As regards the substantive issue of whether traditional (commercial) letters of credit should be covered, the Working Group reaffirmed its decision taken at the twelfth session "that the uniform law should focus on independent guarantees, including stand-by letters of credit, and that it should be extended to traditional letters of credit where that was useful in view of their independent nature and the need for regulating equally relevant issues" (A/CN.9/316, para. 125).

19. A suggestion was made that the type of undertakings covered by the uniform law should be referred to as "independent documentary standby". Such independent documentary standby would be defined as an undertaking by a financial institution to a named beneficiary to answer for the payment or discharge of another's debt against documentary demand, whereby the undertaking is independent from any underlying transaction. Another suggestion, which received considerable support, was that the definition set forth in article 2 should be supplemented by a reference to the guaranteeing function or purpose of the undertakings covered. It was pointed out that such a reference should not be restricted to the principal's default, since that would not cover, for example, financial stand-by letters of credit payable against certification that the principal sum was due. It was also pointed out that such a reference might be unduly restrictive of developing practice and could raise doubts about the independent character of the undertaking.

20. Various comments were made on particular elements of the definition set forth in article 2. It was noted, for example, that it was not clear whether all of the undertakings listed in an illustrative manner were independent. Another comment was that the element of "demand" was missing and that that element might appropriately be added in connection with the reference to conformity. As regards the bracketed wordings relating to request and instruction, one view was in favour of the second alternative since it would recognize the practice of undertakings given by the guarantor on its own account or behalf; another view, however, was in favour of the first alternative. No comments were made on the words between square brackets referring to unit of account or other item of value.

21. Finally, a drafting suggestion was made that the definition should be presented in two parts, the first one dealing with the situation of an undertaking by the guarantor towards the beneficiary at the request of the principal,

and the second one dealing with situations where more than those three persons or institutions were involved.

Article 3. Independence of undertaking

22. The text of draft article 3 as considered by the Working Group was as follows:

"Variant A:

(1) An [international] undertaking is [deemed to be] independent, unless its terms show that the payment obligation depends on the existence or validity of an underlying transaction between the principal and the beneficiary or of any other relationship except that created by the undertaking, or that the guarantor may invoke defences arising from a relationship other than its relationship with the beneficiary.

Variant B:

(1) An undertaking is independent if it does not depend on any underlying transaction or other relationship except that created by the undertaking.

[(2) In determining whether or not a given undertaking is independent, any characterization or a single term found in the text of the undertaking shall not be deemed conclusive if the other terms and conditions clearly weigh in favour of the opposite result. In evaluating the terms and conditions in their totality, the following factors may be regarded as points weighing in favour of independence:

(a) Payment promised on 'simple demand', 'first demand', 'demand', 'receipt of written request' or words of similar import;

(b) Undertaking to pay qualified by expressions such as 'unconditional', 'irrespective of valid existence of X-Contract', 'waiving all rights of objection and defences arising from said contract' or 'without proof of default';

(c) Payment against documents, including statement by beneficiary, and not requiring verification of facts outside guarantor's purview;

(d) Reference to an underlying transaction only in a preamble or otherwise in a recital of what has gone before, and not in operative clauses;

(e) Undertaking stated to be subject to Uniform Customs and Practice for Documentary Credits or Uniform Rules for Guarantees.]"

Paragraph (1)

23. The Working Group was agreed that the principle of independence was sound and fundamental to the uniform law. However, divergent views were expressed as to how the principle should be defined.

24. It was noted that Variant A of paragraph (1) differed from Variant B essentially in two respects. The first one was that it included a rule of interpretation in favour of independence. A view was expressed that this rule was contained in the words "deemed to be". Support was expressed

for such a rule of interpretation since it would help to solve an impasse in case of otherwise insoluble ambiguity and since the suggested solution accorded with the dominant practice and expectations in international guarantee operations. The prevailing view, however, was that the rule of interpretation should not be retained since it might lead to a result not expected by the parties concerned.

25. The second respect in which Variant A differed from Variant B was its considerably more detailed and comprehensive formulation. Proponents of Variant A pointed in particular at those details that specified the various relationships and referred to defences arising from those relationships. However, the very reference to defences accentuated the concern that the exclusion of defences in the context of the definition of independence might be construed as providing a final answer to such questions as whether payment may be refused in case of fraud or manifest abuse, whether illegality of the underlying transaction may have an effect on the undertaking in the guaranty letter, or whether set-off was admissible. That concern was the main reason advanced by proponents of Variant B. Yet another view was that Variant B could be combined with Variant A, except for the above rule of interpretation.

26. It was noted in that connection that the questions raised by those concerned about a preclusive effect of the definition of independence were scheduled to be discussed by the Working Group at its fifteenth session, as indicated by the Secretariat in its note A/CN.9/WG.II/WP.68, para. 2. It was agreed that the definition of independence might have to be reviewed and possibly refined in the light of the future conclusions of the Working Group on those questions concerning possible objections to payment.

27. The Working Group, after deliberation, requested the Secretariat to prepare a revised draft of paragraph (1) based on Variant A, excluding the rule of interpretation in favour of independence, and possibly using some of the wording found in Variant B.

Paragraph (2)

28. Some doubts were expressed as to whether provisions of the kind set forth in paragraph (2) were truly needed and helpful. The prevailing view, however, was that it would be useful to provide some guidance in the interpretation of guaranty letters as regards their legal character. While there was wide support for the rules contained in the opening words of the paragraph, some reservations were expressed concerning the factors set forth in subparagraphs (a) through (e).

29. It was pointed out, for example, that the inclusion of certain specific expressions in subparagraphs (a) and (b) accorded them a particular weight and that difficult questions of interpretation might arise in the case of expressions that were similar or were identical only in part. As regards subparagraph (d), one concern was that the very mention of the underlying transaction might undermine the independent nature of the undertaking. Another concern relating to that subparagraph was that it introduced an inappropriate formalism by attaching legal consequences to the location of the reference to the underlying transaction within the text of the guaranty letter.

30. It was noted that the factors set forth in subparagraphs (a) through (e) were merely designed as factors weighing in favour of independence within the evaluation of the terms and conditions in their totality and were thus not conclusive in isolation. In the light of this, a suggestion was made that the uniform law might give one or more expressions such conclusive status that would put the independent characterization beyond doubt.

31. The Working Group, after deliberation, requested the Secretariat to redraft paragraph (2) in the light of the above views and suggestions.

Article 4. Internationality

32. The text of draft article 4 as considered by the Working Group was as follows:

"Variant A:

A guaranty letter is international if:

(a) any two of the following places specified in the guaranty letter are situated in different States:

- (i) [The place where the guaranty letter was issued][the place of business of the guarantor];
- (ii) The place of business of the beneficiary;
- (iii) The place of payment;
- (iv) The place of business of [a principal or an instructing party][the person at whose request the guaranty letter was issued];
- (v) The place of business of a confirming guarantor;

or

(b) if it expressly so states.

Variant B:

A guaranty letter is international if any two of the following [persons][parties] have their place of business in different States: guarantor, beneficiary, principal, instructing party, confirming guarantor.

Variant C:

A guaranty letter is international if:

(a) the guarantor and the beneficiary have their place of business in different States; or

(b) the place of issue and the place of business of a principal or an instructing party are situated in different States; or

(c) the place of issue and the place of payment are situated in different States;

or

(d) the guaranty letter relates in any other [significant] manner to more than one country.

Variant D:

A guaranty letter is international if it relates to an international operation, whether commercial or financial."

33. The view was expressed that the criteria of internationality set forth in article 4 should be made as broad as possible so as to encompass a maximum number of situations. One proposal to that effect was to define an international guaranty letter along the lines of subparagraph (d) of Variant C as one "relating in any significant manner to more than one country". Another proposal was to adopt the wording of Variant D.

34. It was stated in reply that, although a broad definition of the international guaranty letter was needed, it should not have the effect of covering domestic transactions with minimal international contact. The criteria of internationality should not only result in a broad applicability of the uniform law, but also be as objective as possible. The prevailing view was in favour of Variant B; some doubts were expressed as to the usefulness of the place of business of the confirming guarantor as a criterion of internationality.

35. There was wide support for the view that the criteria of internationality should be drafted so as to provide all parties with the highest possible degree of certainty as to the applicability or the non-applicability of the uniform law to a given transaction. With a view to enhancing certainty, it was proposed that the requirement for specification set out in the opening words of subparagraph (a) of Variant A should be adopted. However, since the requirement of specification might create an excessively rigid rule and a somewhat more flexible rule was more appropriate, another proposal was to add to Variant B a provision similar to article 1(2) of the United Nations Convention on Contracts for the International Sale of Goods (hereinafter referred to as "United Nations Sales Convention"), which reads as follows:

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

36. After deliberation, the Working Group decided to reconsider both proposals at a later stage.

37. With a view towards further broadening the criteria of internationality, it was proposed that the text of subparagraph (b) of Variant A should be added to Variant B. In response, it was stated that such a reference to party autonomy might be unacceptable to many countries since it could enable parties to avoid the application of mandatory provisions of their domestic law. Another concern was that the provisions of article 4 should not conflict with rules on choice of law that would be discussed by the Working Group at its next session. It was noted that the proposed provision would have a different character and produce different results depending on whether the uniform law was eventually adopted in the form of a convention or in the form of a model law. After deliberation, the Working Group decided to adopt the wording of subparagraph (b) of Variant A but to place it between square brackets.

Article 5. Interpretation of this Law

38. The text of draft article 5 as considered by the Working Group was as follows:

"In the interpretation of this Law, regard is to be had to its international [character][origin] and to the need to promote uniformity in its application and the observance of good faith in international [transactions][guaranty or credit practice]."

39. The Working Group was agreed that this article was useful and appropriate if the uniform law would be adopted in the form of a convention. However, it was stated that such a provision would not be appropriate if the uniform law would be adopted in the form of a model law. For example, national courts could hardly be entrusted with the promotion of worldwide uniformity in the application of their own national statute.

40. In response, it was stated that, although article 5 might not be appropriate in its totality if the uniform law would be adopted in the form of a model law, it would still be useful to the extent that it created a standard of good faith. As regards the wording of the reference to good faith, the words "guaranty or credit practice" were preferred to the word "transactions".

41. The Working Group was agreed that article 5 should be placed between square brackets and reconsidered in the light of the future decision on the form of the uniform law and of future discussions relating to the concept of good faith.

Article 6. Construction of guaranty letter

42. The text of draft article 6 as considered by the Working Group was as follows:

"Variant A:

(1) Subject to the provisions of this Law [and of any other applicable law], the rights and obligations of the parties are determined by the terms and conditions set forth in the guaranty letter, including any rules, conditions or usages referred to therein [, and, unless otherwise stipulated, any international usage of which the parties knew or ought to have known and which is widely known to, and regularly observed by, parties to guaranty or credit transactions].

(2) The terms and conditions of the guaranty letter are to be interpreted according to the intent of the parties, taking into account the ordinary meaning in the understanding of a reasonable person with an appreciation of the commercial purpose of the transaction and with due consideration of any practices which the parties have established between themselves.

Variant B:

In determining the rights and obligations of the guarantor and the beneficiary, the terms and conditions set forth, or referred to, in the guaranty letter are to be interpreted according to the ordinary meaning given to them by a reasonable person."

43. The discussion of this article focused on Variant A. This Variant was preferred to Variant B because of its more detailed and comprehensive formulation. Various comments were made in respect of particular elements contained in paragraphs (1) and (2).

Paragraph (1) of Variant A

44. As regards the introductory proviso "Subject to the provisions of this Law", it was understood that it limited party autonomy only to the extent that the uniform law contained mandatory provisions; any non-mandatory provision would, by its nature, be applicable and affect the rights and obligations of the parties only if the matter regulated by that provision was not dealt with by the terms and conditions of the guaranty letter, including any rules, conditions and usages referred to therein. In the preparation of the uniform law, it would have to be decided for each provision whether or not parties may derogate therefrom.

45. As regards the bracketed words "and of any other applicable law", it was stated that those words were redundant, too general to be useful, and potentially misleading and even dangerous. The proposal not to retain them was accepted by the Working Group.

46. The Working Group adopted the central portion of paragraph (1) which reads "the rights and obligations of the parties are determined by the terms and conditions set forth in the guaranty letter, including any rules, conditions or usages referred to therein". It was noted that such rules or usages could, for example, be those prepared by the International Chamber of Commerce. In line with its agreement reached at the thirteenth session (A/CN.9/330, para. 61), the Working Group did not accept a proposal that the uniform law should explicitly refer to the Uniform Customs and Practice for Documentary Credits (UCP) and the Uniform Rules on Demand Guarantees (URG).

47. Divergent views were expressed in respect of the bracketed reference to international usage at the end of paragraph (1). One view was that the wording should be retained since it would accommodate those jurisdictions that gave effect to the UCP or the Incoterms even if not referred to in the guaranty letter and since relevant international usages provided a useful or even necessary source for determining the rights and obligations of the parties and for interpreting the terms and conditions of the guaranty letter. The prevailing view, however, was that the reference to international usages should not be retained since it created uncertainty and might provide a trap to unwary parties.

48. The Working Group, after deliberation, adopted paragraph (1) except for the wordings placed between square brackets.

Paragraph (2) of Variant A

49. Divergent views were expressed as to the first criterion of interpretation mentioned in paragraph (2), namely "the intent of the parties". One view was that the criterion was usually the primary criterion for interpreting contracts or declarations and that it was particularly useful in the

area of guaranty letters since these were often drafted in an ambiguous or imprecise manner.

50. The prevailing view, however, was that the criterion was too subjective and was inappropriate for a guaranty letter that was more formal in character than, say, a sales contract. Additional uncertainty arose from the reference to "the parties" since it was unclear which parties were meant in the context of a given guaranty letter and whether it would, for example, be necessary to know or to inquire who the author of the terms of the guaranty letter was. A more limited proposal that the primary criterion should be the common and established intent of the guarantor and the beneficiary was not accepted by the Working Group.

51. Some support was expressed for retaining the criterion of "the ordinary meaning in the understanding of a reasonable person with an appreciation of the commercial purpose of the transaction". The prevailing view, however, was against its retention since it did not provide sufficient guidance in interpretation in that it was to some extent redundant and, in the typical situation of disputed terms, of little use. A suggestion was made that a more appropriate criterion would be the understanding of a knowledgeable and prudent document checker or the common sense of the banking industry as laid down in bankers' manuals or white papers. It was stated, in reply, that such a criterion was too subjective, uncertain and hardly acceptable to other parties involved in guarantee and credit operations.

52. Some support was expressed for giving due consideration to "any practices which the parties have established between themselves", since this would be in conformity with their intentions and expectations and accord with the principles of good faith or estoppel. The prevailing view, however, was that the interpretation should not be based on previous practices since reliance on extraneous facts was contrary to the principle of strict construction. In this connection, a question was raised whether the provisions of article 6 were rules of interpretation or dispute resolution clauses.

53. It was noted that the concept of strict compliance was dealt with separately in the note by the Secretariat contained in document A/CN.9/WG.II/WP.68. The separate treatment was based on the distinction between the interpretation of the terms and conditions, including the conditions of payment, of the guaranty letter according to article 6 and the verification of compliance of the payment claim with these conditions. A concern was expressed that the distinction was artificial in that bankers regarded the interpretation of the guaranty letter, which to them was relevant only to the submission of documents, and the verification of documentary compliance as one single process in which only one standard should apply.

54. The Working Group, after deliberation, decided not to retain paragraph (2). The decision was not meant to preclude any later proposal for a new rule of interpretation that might be made in the light of future deliberations of other provisions.

Article 7. Form and time of establishment

55. The text of draft article 7 as considered by the Working Group was as follows:

“(1) A guaranty letter may be established by any means of communication that provides a record thereof.

Variant A:

(2) A guaranty letter becomes binding and, unless it expressly states that it is revocable, irrevocable, when it is received by the beneficiary [, unless the beneficiary promptly rejects it]. The guaranty letter becomes effective at that time, unless [it states a different time of effectiveness or makes its effectiveness depend on the occurrence of a specified, uncertain future event, in which case the guarantor may require a declaration from the beneficiary or an appropriate third party stating the occurrence of the event, if verification of that occurrence is not within the control of the guarantor] [it expressly provides that its effectiveness is subject to a specified condition that is determinable by the guarantor].

Variant B:

(2) Unless otherwise stated, a guaranty letter is effective and irrevocable, when it is issued by the guarantor to the beneficiary or to the principal or instructing party.”

Paragraph (1)

56. It was noted that paragraph (1) was modelled on article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration and that it was based on the view, widely supported at the thirteenth session (A/CN.9/330, para. 105), that the guaranty letter should be manifest or recorded in some tangible or material form, to the exclusion of purely oral undertakings. Various comments were made concerning the purpose of the provision and its formulation.

57. A question was raised as to whether paragraph (1) was designed to provide a rule of evidence, as might be inferred from the use of the word “record”. It was stated in reply that the purpose of the provision was to establish the formal requirement of validity of the guaranty letter without taking a stand on the evidentiary value of any form of communication record covered by it. If there was any need for defining certain terms that had evidentiary implications (e.g. signature or authentication) or for including rules of evidence applicable in court or arbitral proceedings, it would be appropriate to consider those matters separately and at a later stage.

58. A proposal was made that the uniform law should merely require that the undertaking be made expressly so as to exclude tacit or implied undertakings. It was agreed that the uniform law should not give effect to tacit or implied undertakings, which were uncertain and undesirable, and that consideration might be given either to disregarding them or to excluding them from the scope of application of the uniform law. It was realized that

whatever decision was taken on that matter it would not address the question of formal validity. With a view to not invalidating purely oral undertakings, a proposal was made that the uniform law should not establish any requirement of form or that it should exclude such undertakings from its scope of application. The Working Group did not accept that proposal, on the ground that purely oral undertakings created uncertainty and did not conform to sound banking practice.

59. While there was wide support for the approach taken in paragraph (1), questions were raised as to whether the provision provided clear answers in all situations. One example was the establishment of a guaranty letter by telephone where the conversation was recorded on tape. The answer given was that this method of establishment would not meet the requirement of form under paragraph (1) since that provision covered only those records provided by the chosen means of communication, i.e. any output of the communication system itself. Another example was the establishment of a guaranty letter by electronic means where the message appeared on the recipient's screen and could still be altered before it was printed out. The answer given was that the form requirement of paragraph (1) was met once the message was either stored in a memory or printed out or otherwise left an audit trail. In this connection, a proposal was made that the record required by paragraph (1) should be one that could not be altered or tampered with. It was stated in reply that such a requirement, while commendable in its aim of creating security and certainty, would be too strict in practical terms.

60. Based on the above example of an electronic message that had not yet been printed out, a proposal was made that the uniform law should require that the guaranty letter be established “in writing or by any other means capable of providing [in an automatic manner] a written record thereof”. Another proposal was to require a “writing” and to define that term as including “an authenticated teletransmission or tested electronic data interchange (‘EDI’) message equivalent thereto”. It was noted that this wording was taken from article 2 URG where the term “writing” was used to delimit the scope of application and not to establish a rule of formal validity.³

61. The Working Group, after deliberation, requested the Secretariat to review and redraft the provision of paragraph (1), taking into account in particular the last proposal.

*Paragraph (2)**Statutory time of effectiveness*

62. Divergent views were expressed as to the point of time when the guaranty letter, unless otherwise stated therein, would be binding and effective. Under one view the determinant point of time should be the receipt by the beneficiary, as provided in Variant A. The main reason given was that the guaranty letter established a

³Articles of URG referred to in this report are those of the ICC Draft Uniform Rules for Demand Guarantees contained in ICC Document No. 460/470-1/Int.16 (7 June 1990).

relationship between the guarantor and the beneficiary and that it was only upon receipt that the beneficiary was in a position to rely on the guarantor's undertaking. Before that point of time, there was no need to bind the guarantor to its undertaking, even though an earlier point of time might be relevant for regulatory or accounting purposes. While no express acceptance of the guaranty letter should be required, receipt of the guaranty letter was a necessary condition for acceptance by silence and for a possible rejection.

63. The prevailing view, however, was that the determinant point of time should be the release or issue of the guaranty letter, as provided in Variant B (and in article 6 URG). It was stated in support that guarantors regarded themselves bound once the guaranty letter had left their sphere of control. The time of issue provided a certain and definite criterion, unlike the time of receipt, which could be difficult or cumbersome to ascertain. Certainty about the time of effectiveness was not only desirable for regulatory or accounting purposes but also of interest and benefit to all parties concerned, including any intermediary banks.

64. It was noted that guaranty letters were not always issued directly to the beneficiary as the ultimate addressee; they might be dispatched to the principal (e.g. in the case of tender guarantees) or an instructing party, as envisaged in Variant B, or even to an advising or confirming bank. In view of the variety of conceivable fact situations, it was agreed not to attempt to list all possible forwarding intermediaries but merely to refer to the time when the guaranty letter was "issued by the guarantor".

Possibility of prompt rejection by beneficiary

65. Some proponents of the time of issue and some proponents of the time of receipt expressed support for the proviso set forth in Variant A "unless the beneficiary promptly rejects it" (i.e. the guaranty letter). Since the guaranty letter created a relationship between the guarantor and the beneficiary, it should not be regarded as being effective where the beneficiary rejected it promptly upon receipt. While no express acceptance should be required, the guaranty letter should not be imposed on an unwilling beneficiary.

66. It was stated in reply that the possibility of rejecting the guaranty letter should be dealt with separately from the time of effectiveness since here certainty was paramount. The very notion of rejection *vis-à-vis* the guarantor was not easily reconciled with the factual situation that the guaranty letter was issued at the request of the principal and presumably in conformity with the terms of the instructions. If a given guaranty letter did not meet the expectations of the beneficiary, it was rarely for the guarantor alone to meet those expectations which, moreover, were more likely to aim at an amendment of the guaranty letter than a total rejection. To the extent that a need for rejection should be recognized by the uniform law, consideration could be given to including a rule on rejection, release or waiver by the beneficiary without however requiring that a rejection had to be made promptly upon receipt.

67. The Working Group, after deliberation, decided to maintain the proviso between square brackets and to reconsider the matter at a later stage.

Clauses in guaranty letters concerning time of effectiveness

68. The Working Group was agreed that the statutory time of effectiveness set by the uniform law should not be determinative when the guaranty letter stated a different time of effectiveness, as provided in Variant A. Such a clause could refer either to a fixed date or to a determinable period of time.

69. The Working Group considered whether the statutory time of effectiveness could be derogated from by a clause in the guaranty letter that would postpone the effectiveness to the time of fulfilment of a specified condition. No objections were raised against clauses under which the fulfilment of the condition was clearly determinable in that fulfilment had to be established by a document or by a written declaration of the beneficiary or another specified person or that its verification was within the purview of the guarantor.

70. However, divergent views were expressed as regards the remaining clauses, which contained so-called non-documentary conditions. Recalling its discussion at the thirteenth session (A/CN.9/330, paras. 68-75), the Working Group was agreed that the problem of non-documentary conditions of effectiveness was essentially the same as that of non-documentary conditions of payment. In fact, one could even regard any condition of effectiveness (e.g. advance payment under a repayment guaranty letter) as a condition of payment.

71. One view was that non-documentary conditions should be disallowed or disregarded, as provided at the end of Variant A in the bracketed wording that was modelled on article 6 URG. It was pointed out that conditions requiring investigation into extraneous facts were undesirable in that they fell outside the ordinary business of banks and tended to undermine the independent character of the undertaking. In fact, one could even regard undertakings with non-documentary conditions as accessory undertakings that were outside the scope of the uniform law. Moreover, non-documentary conditions were often included due to inadvertence; to the extent that they were included intentionally, practice showed that there existed a potential for fraud, abuse or misrepresentation.

72. Based on similar considerations, another view was that non-documentary conditions should be converted into documentary ones, as provided in the bracketed wording of Variant A that "the guarantor may require a declaration from the beneficiary or an appropriate third party stating the occurrence of the event". It was pointed out that this wording reflected the view that prevailed at the thirteenth session (A/CN.9/330, para. 75). A suggestion was made that the formulation of that wording might be refined by taking into account different kinds of conditions. Another suggestion was to recommend to the parties to agree on the means of verification or evidence and, failing agreement, to let a declaration by the beneficiary suffice.

73. Another view, based on different considerations, was that the uniform law should neither disregard non-documentary conditions nor convert them into documentary conditions, but should leave them intact, as provided in Variant B. While a given non-documentary condition might lead to the conclusion that the undertaking was not independent as defined in article 3, that was not always the case, and it would be contrary to the autonomy and expectations of the parties not to respect a condition that formed part of an independent undertaking. The current use of such clauses suggested a practical need therefor and, to the extent that banks regarded them as undesirable or contrary to sound banking practice, it was for them to refuse or discourage their inclusion in guaranty letters.

74. Yet another view, shared by some proponents of the above views, was that consideration might be given to excluding from the scope of application of the uniform law all undertakings that contained any non-documentary condition of effectiveness or payment. If the definition of guaranty letter in article 2 and the definition of independence in article 3 were revised so as to restrict the scope of application to what might be called "documentary guaranty letters", the uniform law would not regulate any undertakings with non-documentary conditions, i.e. neither give effect to such conditions nor invalidate them or convert them into documentary ones. It was stated in reply that non-documentary conditions created considerable problems in practice that called for legal answers. Instead of ignoring or discarding the problem, every effort should be made to finding an acceptable solution, based on further considerations of the kinds of conditions at issue and the precise meaning of independence.

75. The Working Group, after deliberation, decided to reconsider at a future session the problem of non-documentary conditions, including the possibility of limiting the scope of application of the uniform law to documentary undertakings. The Working Group later resumed its discussion on non-documentary conditions (see paragraphs 111-118 below).

III. DISCUSSION OF FURTHER ISSUES OF A UNIFORM LAW: AMENDMENT, TRANSFER, EXPIRY, AND OBLIGATIONS OF GUARANTOR

A. Amendment

76. The Working Group discussed questions relating to the amendment of the guaranty letter on the basis of the considerations and suggestions set forth in the note by the Secretariat (A/CN.9/WG.II/WP.68, paras. 3-17). It was agreed that the uniform law should contain provisions on the amendment of a guaranty letter.

Parties whose consent is required

77. As regards the parties whose consent was required for an amendment to be effective, it was agreed that the guaranty letter could not be modified without the consent

of the guarantor, whose obligations were at stake, and that of the beneficiary, whose rights were at stake. Divergent views were expressed on whether, in addition, the consent of the principal should be required. One view was that an amendment should not be given effect without the principal's consent since the original guaranty letter had been established on the instructions of the principal and the effect of an amendment would be to modify the original terms. The requirement of the principal's consent served also the interest of the guarantor in that it would remove a possible objection by the principal against a later claim for reimbursement.

78. The prevailing view, however, was that the consent of the principal should not be a requirement for the amendment to be effective since the amendment concerned the guaranty letter that created a relationship only between the guarantor and the beneficiary. Any considerations about the instructions or wishes of the principal as well as the guarantor's position in a later claim for reimbursement related exclusively to the separate relationship between the guarantor and the principal.

79. It was felt that these considerations could be addressed in the uniform law, but separately from the rule requiring the consent only of the guarantor and the beneficiary. One proposal was to add such wording as: "This provision does not excuse the failure to obtain the principal's consent, as it may be required by the agreement or instructions between the principal and the guarantor". Another proposal was to require the guarantor to inform the principal about any amendment or any request for an amendment. Yet another proposal was to provide that the guarantor could in its relationship with the principal invoke an amendment only if it had been consented to by the principal.

80. Divergent views were expressed as to whether the beneficiary's consent had to be express or whether silence imported acceptance. One view was that the consent had to be express or, possibly, confirmed by an act or conduct in compliance with the terms of the amendment. It was stated in support that the established relationship could be modified only by a clear agreement of the parties and that express acceptance was, in particular, required where the amendment was to the disadvantage of the beneficiary.

81. Another view was that acceptance could be imported from silence, i.e. where the beneficiary had not rejected the amendment promptly or within a specified period of time. It was pointed out that this view conformed to the approach taken by the Working Group in respect of the establishment of the guaranty letter (article 7(2)) and that it took into account the fact that the bulk of amendments (e.g. extension of validity periods) increased the rights of the beneficiary.

82. The Working Group did not accept a proposal to prepare a dual set of rules depending on whether a given amendment was beneficial or disadvantageous to the beneficiary. It was felt that rules that involved subjective judgments were not easy to administer.

83. The Working Group, after deliberation, was agreed that it would decide at a future session, on the basis of alternative draft provisions prepared by the Secretariat, whether the beneficiary's consent had to be express or whether silence imported consent.

Form of amendment

84. The Working Group was agreed that an amendment could be made in any form in which a guaranty letter could be established according to article 7(1), since there were no reasons for a stricter or for a more lenient requirement of form. Consistency was also appropriate in view of the fact that an amended guaranty letter might be regarded as a new guaranty letter.

85. It was agreed that the provision on the form of amendments should not be mandatory, so as to give effect to any different form of requirement stated in the guaranty letter or otherwise agreed upon by the guarantor and the beneficiary. A view was expressed that the non-mandatory nature of the provision might require further consideration. A proposal was made to add a rule along the lines of article 29 United Nations Sales Convention.

Time of effectiveness

86. The Working Group was agreed that the rule on the time of effectiveness of an amendment should follow the approach taken in respect of the time of effectiveness of the original guaranty letter. It was recalled that, in the context of article 7(2), the Working Group had favoured the time of issue as the determinant point of time and that the proviso referring to the beneficiary's prompt rejection of the guaranty letter had been maintained between square brackets for later reconsideration.

87. It was realized that the future rule on the time of effectiveness of an amendment would depend on which of the two above views (paragraphs 80 and 81) concerning the import of the beneficiary's silence would be adopted. If the decision would be in favour of acceptance by silence, the future rule on amendment could be closely modelled on the rule on establishment that included the proviso. If the decision would be in favour of express acceptance, the time of acceptance could determine the time of effectiveness or the acceptance could be given retroactive effect. The Working Group requested the Secretariat to prepare alternative draft provisions reflecting those views.

B. Transfer of rights and assignment of proceeds

88. The Working Group discussed questions relating to the transfer of rights and the assignment of proceeds on the basis of the considerations and suggestions set forth in the note by the Secretariat (A/CN.9/WG.II/WP.68, paras. 18-23). It was agreed that the distinction, drawn in that note as well as in UCP and URG, between the transfer of the beneficiary's right to claim payment under the guaranty letter and the mere assignment of the proceeds was valid and useful.

Transfer of rights

89. The Working Group was agreed that the beneficiary should not be allowed to transfer its rights without the guarantor's authorization, which could be stated in the guaranty letter or given separately. The requirement of authorization was said to accommodate the guarantor's possible wish as a debtor of not being faced with an unacceptable new creditor and, even more importantly, to accommodate indirectly the interest of the principal in having the rights under the guaranty letter rest with the person whose risk was to be covered by the guaranty letter. The latter consideration was of special importance where the beneficiary was the creditor of an underlying transaction with the principal.

90. A more restrictive proposal was to limit the right of transfer to those cases where the secured creditor under the underlying relationship changed, whether by assignment of the underlying contract or otherwise. In this context, the Working Group discussed the possible effect of such a change on the relationship between the beneficiary and the guarantor. It was noted that divergent conclusions could be drawn, for example, automatic termination of the guaranty letter, or automatic transfer of the beneficiary's rights, or no automatic effect at all, in which latter case any claim by the beneficiary, who was no longer the principal's creditor, might constitute an abuse of rights. The Working Group concluded that there was a need for further study of the problem.

Assignment of proceeds

91. The Working Group was agreed that the beneficiary was free to assign any proceeds that were forthcoming when the guarantor would honour its undertaking under the guaranty letter. While some doubts were expressed as to whether a rule to that effect was needed in the uniform law, the Working Group concluded that such a rule could be useful.

92. Divergent views were expressed as to whether additional rules should be envisaged dealing with notice of assignment to the guarantor and other details of implementation. One view was that it was not appropriate to attempt, in the context of the uniform law, to unify the disparate national laws on assignment and, for example, to regulate notice of assignment as a requirement of validity. Another view was that the uniform law should address those issues that had a direct bearing on the relationship between the beneficiary and the guarantor. One such issue was the requirement of notice, which was relevant for the guarantor's discharging properly its payment obligation. It was stated in reply that the issue of proper discharge embraced other questions as well, for example, bankruptcy of the beneficiary or payment to a collecting agent.

93. The Working Group, after deliberation, requested the Secretariat to prepare draft provisions covering notice and possibly other details of implementation as a basis for a later reconsideration of the matter.

C. Expiry

94. The Working Group discussed questions relating to the expiry of the guaranty letter on the basis of the considerations and suggestions set forth in the note by the Secretariat (A/CN.9/WG.II/WP.68, paras. 24-43). It was agreed that certainty about the expiry was of considerable practical importance and that the uniform law could enhance certainty in two respects, namely as regards the meaning and effect of expiry as stipulated in the guaranty letter and as regards possible requirements relating to expiry clauses.

Meaning and effect of expiry

95. The Working Group was agreed that the meaning of an expiry date stated in the guaranty letter was that a demand for payment, accompanied by any required documents, may be made only before or on that date and that, accordingly, the guarantor was not obliged to pay upon any demand made after that date. In view of the fact that courts of some jurisdictions had given a different interpretation, it was agreed to enshrine that meaning in the uniform law, by a provision along the lines of article 19 URG. Article 19 URG reads:

"A claim shall be made in accordance with the terms of the Guarantee on or before its expiry and, in particular, all documents specified in the Guarantee for the purpose of claiming shall be presented to the Guarantor on or before its expiry at its place of issue, otherwise the claim shall be refused."

96. It was agreed that the future provision should clarify whether the relevant time of making a demand was the time of dispatch by the beneficiary or the time of receipt by the guarantor. No comments were made as to whether the provision should be mandatory.

97. The Working Group was agreed that the effect of expiry was automatic in that it did not depend on any further act such as return of the guaranty letter or a declaration of release by the beneficiary. This understanding should be reflected in the uniform law, at least as regards the issue of return of the guaranty letter, along the lines of article 24 URG, which reads:

"Where a Guarantee has terminated by payment, expiry, cancellation or otherwise, retention of the Guarantee or of any amendments thereto shall not preserve any rights of the Beneficiary under the Guarantee."

98. Consideration might also be given to including a provision like article 23 URG dealing with return of the guaranty letter and release before expiry. It was pointed out that any provision that was taken from the URG would gain a different legal effect when it was incorporated into the uniform law and enacted in a given State in that it would, unlike any contractual provision, displace any provision of law such as one that would make expiry depend on the return of the guarantee instrument.

Possible requirements relating to expiry clauses

99. The Working Group was agreed that expiry clauses could validly refer to a specific date or to a specified period of time after the issue of the guaranty letter. As regards clauses that linked expiry to a certain act, event or other condition, a distinction had to be drawn depending on whether the determination of expiry required a verification or investigation into facts. If no such verification was required because expiry was based on the presentation of certain documents, no serious problems were envisaged, except that there might be a risk of an everlasting undertaking, at least if a document was to be furnished by the beneficiary.

100. However, serious misgivings were expressed as regards those other clauses that required an investigation into facts outside the purview of the guarantor. It was therefore suggested that any non-documentary condition of expiry be read as, or converted into, a documentary one. It was noted that the documentary approach was taken by article 22 URG, which appeared to qualify the presentation of documents itself as an expiry event. Article 22 URG reads:

"Expiry of a Guarantee for the presentation of claims shall be upon a specified calendar date ('Expiry Date') or upon presentation to the Guarantor of the document(s) specified for the purpose of expiry ('Expiry Event'). Claims received after the Expiry Date or Expiry Event shall be refused by the Guarantor."

101. Divergent views were expressed as to whether the uniform law should require guaranty letters to contain an expiry clause and, if so, what the sanction for failure should be. While some support was expressed for invalidating guaranty letters without an expiry clause, the prevailing view was not to require expiry clauses, since guaranty letters without such clauses were found in practice and there might be good reasons for that practice. However, consideration might be given to setting in the uniform law a cut-off period of, say, five years, which would determine the expiry of those guaranty letters that did not contain any expiry clause. In drafting a provision to that effect for later consideration by the Working Group, the Secretariat should take into account the possible interest of parties in extending the validity period beyond that cut-off point.

102. The Working Group, after deliberation, requested the Secretariat to prepare draft provisions on expiry on the basis of the above conclusions and suggestions.

D. Obligations of guarantor

103. The Working Group discussed questions relating to the obligation of the guarantor to pay upon conforming demand (including the issue of the standard of examination as to conformity), based on the considerations and

suggestions set forth in the note by the Secretariat (A/CN.9/WG.II/WP.68, paras. 44-57).⁴

104. As regards the proper form of a demand, the Working Group was agreed that purely oral demands should not be permitted.

105. A proposal was made that the uniform law should list, in the context of fulfilment of payment conditions or in article 3(2)(c), the four main types of guaranty letter commonly used in practice. These types were, briefly described, that payment was due (1) on simple demand, (2) against an additional declaration of the beneficiary about the principal's default, (3) against an additional specification of the obligations breached by the principal, or (4) against documentary evidence of the principal's default (e.g. certificate by third party, judicial or arbitral decision). The proposed listing, which should not be exhaustive, would serve an educational purpose and convey the message that all four types were being used and recognized in international practice. The proposal was opposed on the grounds that the listing of such particulars of ever-developing practice was inappropriate in a law, unless there was a clear regulatory purpose, and that it could be misunderstood as giving special recognition to the four types listed.

106. As regards the standard of examination of documents, wide support was expressed for including in the uniform law a provision along the lines of article 9 URG. Article 9 URG reads:

"All document(s) specified and presented under a Guarantee, including the claim, shall be examined by the Guarantor with reasonable care to ascertain whether or not they appear on their face to conform with the terms of the Guarantee. Where such document(s) do not appear so to conform or appear on their face to be inconsistent with one another, they shall be refused."

107. Particular support was expressed for the notion of facial conformity and the requirement of reasonable care. Various suggestions were made with a view to providing further guidance relating to the notion of facial conformity and the requirement of reasonable care. One suggestion was that the uniform law should enshrine the principle of strict compliance of the documents with the terms of the guaranty letter. It was pointed out, however, that this commonly accepted principle might not provide clear answers as to the tolerable degree of deviations and that there might be fewer occasions for its application in the context of guaranty letters than there were in the context of commercial letters of credit. Another suggestion was that the requirement of reasonable care should be interpreted in the light of established customs and practice. Yet another suggestion was that the reasonable care required of the guarantor should be determined according to the conduct of the most diligent issuers of guaranty letters. It was stated in reply that any standard of care had to be

judged with respect to the relevant group of persons and that, in a situation with potentially conflicting interests, no preference should be given to one such group of persons.

108. Based on the aforementioned discussion in the Working Group the following wording was proposed:

"When construing the terms and conditions of independent guarantees or stand-by letters of credit, the guarantor or issuer must do so strictly, that is by using reasonable care to establish facial conformity, to be judged in accordance with the best standards of independent guarantee and stand-by letter of credit practice."

109. While there was wide support for the approach taken in that proposal, concerns were expressed as regards its wording. One concern was that the standard to be applied to the guarantor's conduct was described in a somewhat circular manner. Another concern was that the reference to the best standards of independent guarantee and stand-by letter of credit practice might be too general to provide clear answers in specific cases where guidance was needed. Yet another concern was that the reference to the "best" standards, while commendable in its aim, might not be generally acceptable.

110. The Working Group, after deliberation, decided to continue its consideration of the proposal at a future session and requested the Secretariat to prepare alternative draft versions based on the proposal and on article 9 URG.

E. Treatment of non-documentary conditions

111. In response to a strongly expressed concern, the Working Group resumed its discussion on non-documentary conditions that it had engaged in when considering Variant A of draft article 7(2) (see above, paragraphs 70-75). The concern was that the problem of non-documentary conditions was a fundamental one that had implications on all issues to be discussed in the preparation of the uniform law. It was said that it called for a prompt and satisfactory solution, which would be to restrict the scope of application of the uniform law to those independent undertakings that were documentary in nature. Non-documentary conditions were highly undesirable since they created uncertainty and placed on banks a burden of examining extraneous facts that was outside their ordinary business (as described by the maxim: banks deal in documents and not in goods).

112. Non-documentary conditions were said to enter into the texts of guarantee undertakings in two different kinds of ways. The first one was described as negligence or inadvertence of the issuing bank that, for example, forgot to mention one of the various documents normally required for the type of undertaking at hand. The second one was described as intent or design by the guarantor and, presumably, the principal, for example, where in an apparently independent and documentary guarantee a non-documentary condition relating to the underlying transaction was included. It seemed appropriate to cover situations of the first type in the uniform law and either

⁴For lack of time, the Working Group did not consider the issues of the time allowed for examination, duties of notification, and liability and exemption discussed in document A/CN.9/WG.II/WP.68, paras. 58-72.

to ignore the non-documentary condition or to convert it into a documentary condition. However, situations of the second type should be excluded from the scope of application of the uniform law. Undertakings given in such situations should not be accorded credibility or an aura of certainty.

113. On the basis of the above concern the following proposal was made:

"1. *Scope*: This project encompasses only independent documentary undertakings.

2. Where an undertaking is so drafted as to be essentially an independent documentary undertaking but it includes a condition which is not required to be supported by a document and if that condition does not have the effect of rendering the undertaking to be essentially non-documentary, it will fall within the scope of the UNCITRAL law/convention. The non-documentary condition will either be ignored or converted into a documentary condition depending upon the decision of the Working Group in future sessions.

3. Where an undertaking is so drafted as to be essentially non-documentary even though it includes documentary conditions, it will not come within the scope of the UNCITRAL law/convention. Whether it is enforceable and under what terms will be solely a matter of municipal law.

4. The determination of whether an undertaking is essentially documentary or non-documentary must be made by examining the nature of the undertaking in light of guaranty/stand-by practice in order to determine whether it is of the type and format customarily issued as a non-documentary or as a documentary undertaking."

114. Various comments were made concerning the concept and purpose underlying the proposal, the appropriateness of the suggested solution and the distinction between an essentially documentary and an essentially non-documentary undertaking. As regards the underlying concept, it transpired during the discussion that the proposal was based on an approximation of the independent and the documentary character of the undertaking. The purpose of that approach was to restrict the scope of application of the uniform law more than was currently done by the requirement of an independent undertaking as defined in draft article 3, in that the proposal covered non-documentary conditions that did not render the undertaking accessory by providing the guarantor with a defence arising from the underlying transaction.

115. Divergent views were expressed as to the suggested solution of excluding such types of undertakings from the scope of application of the uniform law. One view was that the solution was acceptable since it would leave intact party autonomy but not encourage the use of such uncertain undertakings or give them credibility. Another view was that it was desirable, instead of leaving those undertakings to the disparate and uncertain national laws, to regulate them in the uniform law, in particular if

they created problems that could not be avoided or taken care of by the banks themselves. Yet another view was that, while the exclusion of such undertakings from the scope of application might appear to be desirable, acceptance of that solution would ultimately depend on whether one could draw a precise demarcation line between those types of undertakings that should be excluded and those that should be included in the scope of application of the uniform law.

116. Support was expressed for the distinction drawn in the above proposal between essentially documentary and essentially non-documentary undertakings. Doubts were expressed, however, in respect of the rule of interpretation suggested in the last part of the proposal (subparagraph 4). It was doubted, for example, whether it was appropriate and fair in situations involving three persons with potentially conflicting interests to refer to what is customarily issued. Another doubt was whether there in fact existed sufficiently precise types and formats of undertakings that could provide clear answers in the doubtful cases where guidance was needed. To the extent that the distinction was reflective of the distinction between inadvertent and intentional inclusion of non-documentary conditions, another doubt was whether that would not introduce an element of subjectivity and uncertainty. It was stated in reply that the notion of intent had to be understood in an objectivized manner, that sufficiently precise types and formats of undertakings had been evolving in practice and a synopsized description thereof could usefully be included in the definitional section of the uniform law. Furthermore, it was stated that in a situation of potential conflict between the principal and the beneficiary it was for the guarantor to play a neutral role as a trusted and reliable paymaster.

117. With a view to reducing the uncertainty surrounding the suggested distinction, a suggestion was made that an undertaking in which certain words such as "independent documentary standby" were used should be deemed to be essentially documentary. Another suggestion was to define clearly the term "non-documentary condition" and, in particular, to determine what kinds of condition should be treated as non-documentary.

118. The Working Group, after deliberation, was agreed that the problem of non-documentary conditions which had given rise to the above concern was a fundamental and complex one, and that the proposal to exclude essentially non-documentary undertakings from the scope of application of the uniform law provided a useful basis for further deliberations that were needed for finding a satisfactory solution.

IV. OTHER BUSINESS

119. The Working Group decided to hold its fifteenth session from 13 to 24 May 1991 in New York. Subject to approval by the Commission at its twenty-fourth session (Vienna, 10-28 June 1991), the Working Group would hold its sixteenth session from 4 to 15 November 1991 at Vienna.

B. Working papers submitted to the Working Group on International Contract Practices at its fourteenth session

1. Independent guarantees and stand-by letters of credit:
uniform law on international guaranty letters:
first draft of general provisions and article on establishment:
note by the Secretariat (A/CN.9/WG.II/WP.67) [Original: English]

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INTRODUCTION

1. At its thirteenth session, the Working Group on International Contract Practices considered, on the basis of a note by the Secretariat (A/CN.9/WG.II/WP.65), possible issues of a uniform law on independent guarantees and stand-by letters of credit (A/CN.9/330). Those issues concerned the substantive scope of the uniform law, party autonomy and its limits, and possible rules of interpretation. The Working Group also engaged in a preliminary exchange of views on issues relating to the form and time of establishment of a guaranty letter. It requested the Secretariat to submit at the next session a first draft set of articles, with possible variants, on the issues considered during the thirteenth session.

2. The present note has been prepared pursuant to that request. It presents a first draft of general provisions relating to substantive scope and to interpretation, as well as a first draft of an article on establishment.

3. The style of presentation aims at facilitating the deliberations and decisions of the Working Group on the various issues dealt with in the draft provisions. Alternative wordings or particularly tentative suggestions are usually placed between square brackets; some alternative wordings that are elaborate or present different approaches are labelled as Variants. A Variant may contain an element that is interchangeable in that it may be used in connection with another Variant, depending on the Working Group's decision on the issue dealt with in that element. Once the Working Group has decided on an alternative wording or part thereof, the selected wording will be reviewed by the Secretariat for comprehensiveness and style.

4. Each draft provision is followed by remarks providing brief explanations of the draft provision and its elements or Variants; individual paragraph numbers of the remarks are placed as indicators (between square brackets, e.g. [3]) at that portion of the draft provision to which the remark most closely relates. For the sake of brevity, the remarks do not normally repeat or refer to the relevant considerations and conclusions of the Working Group at its thirteenth session which may be easily gathered from the report of that session (A/CN.9/330).

I. GENERAL PROVISIONS

Article 1. *Scope of application* [1]

This Law [2] applies to an international guaranty letter [3] [issued in this State] [4].

Remarks

1. The draft provisions in this note are given article headings for ease of reference during the considerations of the Working Group. If it were later decided to maintain headings in the final version, consideration could be given to adding an explanatory footnote like the one found in the UNCITRAL Model Law on International Commercial Arbitration: "Article headings are for reference purposes only and are not to be used for purposes of interpretation".

2. As regards the suggested use of the term "Law", it should be recalled that the mandate of the Working Group is to undertake work on a uniform law, whether in the form of a model law or in the form of a convention, and

that the Working Group agreed to decide that question of form at a later stage. If the decision were to be in favour of the form of a convention, adjustments would have to be made in this and other draft provisions.

3. The term "international" is defined in draft article 4 and a definition of the term "guaranty letter" is provided in draft article 2.

4. The words between square brackets have been added primarily for the purpose of showing an appropriate location for any criterion of the territorial scope of application. While the suggested criterion might invite tentative consideration of the matter, a full discussion would probably be more appropriate at a later stage, in connection with possible rules on conflict of laws.

* * *

Article 2. *Guaranty letter* [1]

A guaranty letter, whether or not named guaranty letter, guarantee, bond, indemnity or stand-by letter of credit, [2] is an independent [3] undertaking, given by a bank or other institution or person ("guarantor") [at the request of its customer ("principal") or on the instruction of another bank, institution or person ("instructing party") acting at the request of its customer ("principal")] [4] [, whether or not so requested or instructed by another institution or person], [5] to pay to another person ("beneficiary") [6] a certain or determinable amount of a specified currency [, unit of account or other item of value] [7] in conformity with the terms of the undertaking.

Remarks

1. This draft provision presents a single definition of guaranty letter encompassing independent guarantees and stand-by letters of credit. This unitary approach seems justified in view of their functional equivalence and essentially similar legal character. If a dual approach with two separate definitions were deemed necessary or preferable, consideration could be given to modelling the definitions on those found in the draft ICC Uniform Rules for Guarantees (URG) and the Uniform Customs and Practice for Documentary Credits (UCP). However, as regards the definition of "credit" in article 2 UCP, it would probably be necessary to express the guarantee function of a stand-by letter of credit, in contrast to the secured payment function of a traditional commercial letter of credit, by adding wording such as "given for the purpose of securing the beneficiary against the default of the principal or against another specified risk".

2. This wording is inspired by the words in article 1 URG "however named or described". It serves the purpose of clarifying that an undertaking may qualify as a guaranty letter irrespective of its name and indeed even without bearing any name. The suggested wording may serve the further purpose of illustrating the more common types of independent undertakings likely to fall under the new

heading "guaranty letter". To further this aim of illustration and information, the list of types of undertakings should be carefully considered with a view to presenting the most appropriate names hitherto used in the various regions and languages.

3. The term "independent" is defined in draft article 3.

4. This wording is a shortened version of the corresponding element in article 2 (a) URG. It leaves out, in particular, the words "and under the liability" (of the principal or the instructing party), which do not seem appropriate in the definition of an independent undertaking. The wording does not provide an appropriate context for defining such terms as "counter-guaranty letter" or "confirmation of guaranty letter", even though it covers those types of guaranty letters. The need for such definitions depends on whether any special provisions for these types of guaranty letter will be included in the operative rules of the uniform law.

5. This wording, by not requiring a request (of the principal or instructing party), includes those undertakings given by the guarantor on its own account or behalf, that is where one party is both guarantor and principal. Since this wording does not provide a context for any definitions, they would have to be presented, if deemed necessary, in other provisions.

6. Consideration may be given to adding the words "or persons" so as clearly to cover a possible plurality of beneficiaries as found, in particular, in the practice of financial stand-by letters of credit, which are customarily issued to multiple beneficiaries or to fiduciary representatives of multiple beneficiaries or sub-beneficiaries. This clarification may help to overcome problems in those jurisdictions where the rules of statutory interpretation would not lead to the conclusion that the singular includes the plural.

7. The wording between square brackets would embrace more than the expression "payment of money" found in article 2 URG. It would include units of account, as provided for in greater detail in article 5(1) of the United Nations Convention on International Bills of Exchange and International Promissory Notes (hereinafter referred to as "UNCITRAL Bills and Notes Convention"). Moreover, it would meet the concern expressed at the thirteenth session that a reference to the payment of money or currency might be too narrow in that it would exclude, for example, an undertaking to pay in gold (A/CN.9/330, para. 21).

* * *

Article 3. *Independence of undertaking* [1]

Variant A: [2]

(1) An [international] [3] undertaking is [deemed to be] [4] independent, unless its terms [5] show that the payment obligation depends on the existence or validity of an underlying transaction between the principal and the beneficiary or of any other relationship except that

created by the undertaking, or that the guarantor may invoke defences arising from a relationship other than its relationship with the beneficiary [6].

Variant B: [7]

(1) An undertaking is independent if it does not depend on any underlying transaction or other relationship except that created by the undertaking.

[(2)[8] In determining whether or not a given undertaking is independent, any characterization or a single term found in the text of the undertaking shall not be deemed conclusive if the other terms and conditions clearly weigh in favour of the opposite result. In evaluating the terms and conditions in their totality, the following factors may be regarded as points weighing in favour of independence:

(a) Payment promised on "simple demand", "first demand", "demand", "receipt of written request" or words of similar import;

(b) Undertaking to pay qualified by expressions such as "unconditional", "irrespective of valid existence of X-Contract", "waiving all rights of objection and defences arising from said contract" or "without proof of default";

(c) Payment against documents, including statement by beneficiary, and not requiring verification of facts outside guarantor's purview;

(d) Reference to an underlying transaction only in a preamble or otherwise in a recital of what has gone before, and not in operative clauses;

(e) Undertaking stated to be subject to Uniform Customs and Practice for Documentary Credits or Uniform Rules for Guarantees.]

Remarks

1. This draft provision attempts to define the term "independent" used as a qualifying criterion in draft article 2. It may be noted that the term "independent" is defined here not merely as the opposite of "accessory", i.e. dependent on the underlying transaction between the principal and the beneficiary. The principle of independence as embodied in this draft provision is wider in that it establishes the autonomous character also in respect of other relationships such as that of the guarantor with a principal or instructing party.

2. Variant A is considerably more detailed than Variant B; its details will be explained below (remarks 3 to 6). Another difference that may be less obvious is that it incorporates a suggestion which the Working Group agreed to reconsider on the basis of a Secretariat draft. The suggestion was to regard an international undertaking as independent if it could not be interpreted as either independent or accessory (A/CN.9/330, paras. 95-96). While Variant B would not help in such case of doubt, Variant A solves the impasse of interpretation by excluding from the scope of application only those undertakings that are to be characterized as accessory or otherwise dependent, based on whatever rules of interpretation the Working Group may agree on.

3. The word "international" is not necessary in view of draft article 1. However, it might usefully be repeated here so as to emphasize that the suggested rule of favouring, in case of doubt, the independent legal character is limited to international undertakings.

4. The words "deemed to be" may, strictly speaking, not be correct as regards clearly independent undertakings. However, they may help to emphasize the above rule of doubt that, for the purposes of the uniform law, an undertaking will be treated as independent if it cannot be characterized as dependent.

5. Consideration may be given to adding after the words "its terms" the words "as interpreted in accordance with article 6 and paragraph (2) of this article". If the referred rules of interpretation were to be included in the uniform law, the suggested addition might help to clarify that a serious process of interpretation is required before such a level of doubt is established as to trigger the operation of the above rule.

6. Variant A defines in substance the term "dependent" by spelling out the possible links that negate the independent or autonomous character of the undertaking. It is submitted that the suggested demarcation line between "dependent" and "independent" is correct in principle. However, it will have to be reviewed and possibly refined in the light of the Working Group's conclusions on such issues as non-documentary conditions of effectiveness or payment, possible effect of illegality of the underlying transaction on the guarantor's obligation, and the extent to which facts pertaining to the underlying transaction may be asserted in the context of invoking fraud or manifest abuse.

7. Variant B is presented for two reasons. First, it is to show the opening words of a straightforward definition that does not incorporate the above rule of favouring independence in case of insoluble doubt. Secondly, it is to invite consideration of another definition of "independent" that is considerably shorter than that presented in Variant A.

8. Paragraph (2) is presented between square brackets with a view to soliciting the views of the Working Group on whether the uniform law should contain special guidelines for determining the independent character of an undertaking and whether it should go into such details, embracing current practice and actual language, as found in the sample indicators of independence. The paragraph also incorporates the suggested rule that a label or characterization may be disregarded in the light of conflicting terms found in the guaranty letter.

* * *

Article 4. *Internationality* [1]

Variant A: [2]

A guaranty letter is international if:

(a) any two of the following places specified in the guaranty letter are situated in different States:

- (i) [The place where the guaranty letter was issued][the place of business of the guarantor];
- (ii) The place of business of the beneficiary;
- (iii) The place of payment;
- (iv) The place of business of [a principal or an instructing party][the person at whose request the guaranty letter was issued];
- (v) The place of business of a confirming guarantor;

or

- (b) if it expressly so states.

Variant B: [3]

A guaranty letter is international if any two of the following [persons][parties] have their place of business in different States: guarantor, beneficiary, principal, instructing party, confirming guarantor.

Variant C: [4]

A guaranty letter is international if:

- (a) the guarantor and the beneficiary have their place of business in different States; or
- (b) the place of issue and the place of business of a principal or an instructing party are situated in different States; or
- (c) the place of issue and the place of payment are situated in different States;

or

- (d) the guaranty letter relates in any other [significant] manner to more than one country.

Variant D: [5]

A guaranty letter is international if it relates to an international operation, whether commercial or financial.

Remarks

1. This draft provision defines the term "international" used in draft article 1 and might later be added to that article. It presents four variants pursuant to the Working Group's request that the Secretariat prepare alternative draft versions of a test of internationality, taking into account the views and suggestions expressed at the thirteenth session (A/CN.9/330, paras. 51-57).

2. Variant A, like Variant B, lists a number of places out of which two must be in different States for a guaranty letter to be international. However, it requires those places to be specified in the guaranty letter so that banking and other personnel handling it may easily ascertain whether it is international. While the list of places in subparagraph (a) already covers the bulk of possible international links, subparagraph (b) would widen the scope of application by giving effect to a statement in the guaranty letter that it be regarded as international—in effect an opting-in clause in disguise. Such an option, which might also be included in Variant B, seems more appropriate in the context of Variant A with its requirement of

specification. It could, for example, be used by the issuer of a financial stand-by letter of credit even though the place of business of the beneficiary or beneficiaries, likely to be foreign, is not specified or not even known.

3. Variant B differs from Variant A in two additional respects. It does not include the place of payment, which rarely differs from that of issue, and it lists the places of business of a principal and an instructing party as separate connecting factors, thus covering the case where a principal requests a bank in a different State to instruct another bank in that State to issue the guaranty letter. As regards the term "place of business", used also in Variants A and C, consideration may be given to supplementing the term by rules for those cases where a party has more than one place of business or does not have a place of business (along the lines of, e.g., article 10 United Nations Convention on Contracts for the International Sale of Goods, hereinafter referred to as "United Nations Sales Convention").

4. Variant C envisages only three defined links but embraces an uncertain number of other possible links by its subparagraph (d). This flexible formula introduces a degree of imprecision that may be undesirable at least if serious legal consequences would ensue.

5. Variant D is even more flexible and uncertain. While it may be appropriate in a given national law, where it is likely to have been developed by established case law, it seems less appropriate in a new uniform law of global origin and design.

* * *

Article 5. Interpretation of this Law

In the interpretation of this Law, regard is to be had to its international [character][origin][1] and to the need to promote uniformity in its application and the observance of good faith in international [transactions][guaranty or credit practice].[2]

Remarks

1. The term "character" has been used in various Conventions emanating from the Commission's work and would certainly be appropriate if the uniform law were to be adopted in the form of a convention. It might also be appropriate if the uniform law were to be promulgated in the form of a model law. In that case, it may, however, be technically more accurate to refer to its international origin.

2. The general term "transactions" has been used in the UNCITRAL Bills and Notes Convention and appears to be equally appropriate for the uniform law. However, if a more specific term were to be sought, the suggested alternative wording "guaranty or credit practice" might be the answer, particularly if the final uniform law would cover traditional commercial letters of credit.

* * *

Article 6. *Construction of guaranty letter* [1]

Variant A: [2]

(1) Subject to the provisions of this Law [and of any other applicable law][3], the rights and obligations of the parties are determined by the terms and conditions set forth in the guaranty letter, including any rules, conditions or usages referred to therein[4] [, and, unless otherwise stipulated, any international usage of which the parties knew or ought to have known and which is widely known to, and regularly observed by, parties to guaranty or credit transactions][5].

(2) The terms and conditions of the guaranty letter are to be interpreted according to the intent of the parties[6], taking into account the ordinary meaning in the understanding of a reasonable person with an appreciation of the commercial purpose of the transaction and with due consideration of any practices which the parties have established between themselves.[7]

Variant B: [8]

In determining the rights and obligations of the guarantor and the beneficiary, the terms and conditions set forth, or referred to, in the guaranty letter are to be interpreted according to the ordinary meaning given to them by a reasonable person.

Remarks

1. The article heading might be modified if Variant A is maintained. It could, for example, read: "Determination of rights and obligations".

2. Paragraph (1) of Variant A is designed to introduce the principle of strict construction and to address the issue of party autonomy and its limits. The combination of both matters serves to draw attention to the fact that the rights and obligations flow from the terms of the undertaking but may be affected by mandatory provisions of law. As regards provisions of the uniform law itself, it will have to be decided for each provision whether or not parties may derogate therefrom.

3. The bracketed reference to "any other applicable law" might serve as a useful reminder of the fact that the rights and obligations of the parties may be affected by various mandatory provisions of law dealing with issues not governed by the uniform law (e.g. exchange control, supervision of banks, capacity of parties or bankruptcy). However, such a reference has not normally been included in comparable legal texts and might be regarded as too general to be useful.

4. A reference in the guaranty letter to rules (e.g. uniform rules), conditions (e.g. general conditions) or usages does not affect the parties' rights and obligations if the reference is not valid under the applicable law. However, it does not seem necessary to express the requirement of validity in the draft provision.

5. The wording between square brackets is modelled on article 9(2) of the United Nations Sales Convention.

Despite the difference in subject matter, there may be a need in the uniform law for giving effect to an international usage by way of implied agreement. However, the need might be less felt if the Working Group were to retain the incorporation of rules and usages in the guaranty letter (see above, remark 4) and the reference to any other applicable law (see above, remark 3) which could, for example, be customary law on letters of credit. If a more straightforward formula were to be desired, an international usage could be recognized even without an implied agreement and the element of knowledge.

6. The reference to the parties' intent as primary criterion of interpretation is inspired by article 8(1) of the United Nations Sales Convention. However, it is there used in respect of an individual party and given effect only where the other party knew or could not have been unaware what the intent was. The uniform law could use that individualized formula if, focusing on the undertaking, it would restrict the rule of interpretation to the rights and obligations of the guarantor. If applied to both parties, the criterion of intent retains its importance but seems in need of qualification by some flexible wording.

7. The suggested rule of interpretation attempts to strike a balance between the need for strictness in giving full faith and credit to the letter of the undertaking and the need for flexibility in introducing factors not necessarily apparent from the guaranty letter. While the balance is not easily struck, the suggested rule is thought to further two important policy objectives, namely to meet the expectations of the parties and to ensure the commercial utility of independent undertakings.

8. Variant B introduces the rule of interpretation with opening words that state the purpose of the interpretation and thereby reflect the idea of strict construction less directly than does paragraph (1) of Variant A. In respect of both Variants, it may be noted that the related issue of the standard of compliance of the claim with the terms of the guaranty letter will be addressed in a separate draft provision, in a future chapter devoted to the demand for payment.

* * *

II. ESTABLISHMENT, AMENDMENT AND EXPIRY

Article 7. *Form and time of establishment* [1]

(1) A guaranty letter may be established by any means of communication that provides a record thereof.[2]

Variant A [3]:

(2) A guaranty letter becomes binding and, unless it expressly states that it is revocable, irrevocable, when it is received by the beneficiary [4][, unless the beneficiary promptly rejects it]. The guaranty letter

becomes effective at that time [5], unless [it states a different time of effectiveness or makes its effectiveness depend on the occurrence of a specified, uncertain future event, in which case the guarantor may require a declaration from the beneficiary or an appropriate third party stating the occurrence of the event, if verification of that occurrence is not within the control of the guarantor][6] [it expressly provides that its effectiveness is subject to a specified condition that is determinable by the guarantor][7].

Variant B: [8]

(2) Unless otherwise stated, a guaranty letter is effective and irrevocable, when it is issued by the guarantor to the beneficiary or to the principal or instructing party.[9]

Remarks

1. This draft provision on form and time applies to the establishment of a guaranty letter, that is, an undertaking meeting the essential requirements set forth in draft article 2. Whether the same rules on form and time should be applicable to later changes (e.g., amendment or cancellation) and to other communications (e.g. demand or notice) will be considered in a note by the Secretariat discussing further possible issues of the uniform law (A/CN.9/WG.II/WP.68).

2. Paragraph (1) is modelled on article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration. It is based on the view, widely supported at the thirteenth session (A/CN.9/330, para. 105), that the guaranty letter should be manifest or recorded in some tangible or material form, to the exclusion of purely oral undertakings.

3. Variant A of paragraph (2) is considerably more detailed than Variant B. While Variant B uses the expression "unless otherwise stated" for the entire paragraph, Variant A specifies what stipulations to the contrary would be admissible, in particular, as regards the time of effectiveness. Both Variants implement the Working Group's decision that the uniform law should provide for the irrevocability of all undertakings covered by it unless otherwise stated in the guaranty letter (A/CN.9/330, para. 102). That rule would override current article 7(c) UCP which, in case of silence, treats letters of credit as revocable.

4. Variant A uses as the determinant point of time the receipt of the guaranty letter by the beneficiary. That is based on the consideration that it is only at that time that the beneficiary is in a position to rely on the guarantor's undertaking. The suggested rule does not take a stand on whether the undertaking is to be characterized as a contract, be it bilateral or unilateral, or as a special creation of commercial law. Whichever characterization would be appropriate, there appears to be general agreement in law and practice that no express acceptance by the beneficiary is required. However, consideration may be given to

including a proviso on possible refusal of acceptance, as suggested at the end of the first sentence. If that proviso were maintained, consideration may be given to addressing such issues as qualified acceptance, legal effect of undertaking before rejection, or decisive point of time of rejection.

5. Variant A draws a distinction between "binding" and "effective". Without attempting here to define these terms, "binding" would indicate the existence of a promise made with the intention to be legally bound; such binding promise may, for example, establish the guarantor's right to charge a fee and it may be revoked, if revocable. "Effective" would indicate the operative character of the undertaking, entitling the beneficiary to demand payment in conformity with the payment conditions. For example, a repayment guarantee would be binding, but not effective, before the advance payment was made by the beneficiary or known to the guarantor.

6. The wording between square brackets presents two exceptions to the rule on the point of time of effectiveness. First, the guaranty letter may postpone the effectiveness to a later point of time, either a fixed date or a determinable time. Secondly, the guaranty letter may make its effectiveness subject to a condition; the suggested wording would not invalidate non-documentary conditions of effectiveness but would convert them into documentary ones. While conditions of effectiveness might be treated differently from payment conditions, as discussed during the thirteenth session (A/CN.9/330, para. 69), consideration may later be given to dealing with both types of conditions in one draft provision.

7. The alternative wording between square brackets is modelled on article 6 URG. It does not include the first exception, i.e. different time of effectiveness, and would invalidate or disregard any condition of effectiveness that was not determinable by the guarantor.

8. As indicated above (remark 3), Variant B would permit the parties to derogate from the entire draft provision. If it were adopted, the issue of non-documentary conditions of effectiveness would have to be dealt with in a separate provision, possibly in connection with non-documentary conditions of payment.

9. Variant B uses as the determinant point of time the issuance of the guaranty letter. That is based on the consideration that the guaranty letter, when issued or sent, leaves the sphere of control of the guarantor. In this respect, it might be regarded as irrelevant whether the guaranty letter is released towards the beneficiary or towards the principal or instructing party. While the rule would place the risk of transmission on the beneficiary, consideration may be given to distinguishing between the point of time of effectiveness and the risk of transmission.

**2. Independent guarantees and stand-by letters of credit:
discussion of further issues of a uniform law:
amendment, transfer, expiry, obligations of guarantor,
liability and exemption: note by the Secretariat
(A/CN.9/WG.II/WP.68) [Original: English]**

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INTRODUCTION

1. At its thirteenth session, the Working Group on International Contract Practices considered, on the basis of a note by the Secretariat (A/CN.9/WG.II/WP.65), possible issues of a uniform law on independent guarantees and stand-by letters of credit (A/CN.9/330). Those issues concerned the substantive scope of the uniform law, party autonomy and its limits, and possible rules of interpretation. The Working Group also engaged in a preliminary exchange of views on issues relating to the form and time of establishment of a guaranty letter. It requested the Secretariat to submit to the next session a note discussing further possible issues to be covered by the uniform law (A/CN.9/330, para. 110).

2. The present note has been prepared pursuant to that request. It presents a discussion of issues relating to amendment, transfer and expiry of the guaranty letter, to obligations of the guarantor as well as liability and exemption. The Secretariat intends to submit at the fifteenth session of the Working Group a further note discussing the remaining issues: fraud and other objections to payment,

injunctions and other court measures, conflict of laws and jurisdiction.

I. AMENDMENT

3. The Working Group may wish to consider whether the uniform law should contain provisions on the amendment of a guaranty letter. Such provisions could address questions such as the form and time of effectiveness of an amendment and whose consent is necessary for an amendment to be effective.

4. It may be noted that the ICC Draft Uniform Rules for Demand Guarantees (URG)¹ do not contain any special

¹ICC Document No. 460/470-1/Int. 16, 470/622 and 460/382 (7 June 1990). This latest draft, which was not available to the Secretariat when preparing document A/CN.9/WG.II/WP.67, incorporates changes in the title, the introduction, articles 1, 2, 4 and 20. It seems particularly noteworthy that according to article 2 the rules now cover stand-by letters of credit. The introduction states: "Although for the time being UCP 400 also applies to stand-by letters of credit, it is envisaged that the present rules will be those adopted by parties to stand-by letters of credit".

provision on amendment, even though amendments are mentioned in some of its provisions (e.g. articles 1, 3, 16, 23 and 24). Presumably, the provisions on form and time of effectiveness of the original guarantee (articles 2(a) and 6) are meant to apply by analogy to a later amendment.

5. The Uniform Customs and Practice for Documentary Credits (UCP)² contain a number of provisions dealing with amendments to credits. For example, article 12 UCP sets forth the circumstances under which an instruction by any teletransmission to advise an amendment to a credit constitutes the operative amendment. According to article 10 (d) UCP irrevocable "undertakings can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank (if any), and the beneficiary. Partial acceptance of amendments contained in one advice of amendment is not effective without the agreement of all the above named parties." The Working Group may wish to use this list of parties as a basis for its discussion on whose consent is needed for an amendment of the guaranty letter to be effective.

A. Parties whose consent is required

6. It is obvious that an amendment cannot be effective without the consent of the guarantor, whether it issued or confirmed the original guaranty letter. While the consent of the beneficiary may be viewed as an equally obvious requirement, doubts might arise with respect to amendments that increase the beneficiary's rights (e.g. extension of validity period). However, a particular increase in the beneficiary's rights may not necessarily be acceptable to the beneficiary since, for example, it may have requested an even longer extension of the validity period. Moreover, it would not be easy to administer a rule that would depend on whether the amendment in question was to the beneficiary's advantage.

7. As in the context of the establishment of the original guaranty letter, consent need not necessarily mean express acceptance. Along the lines of Variant A of draft article 7(2) (A/CN.9/WG.II/WP.67), an amendment could become effective upon receipt by the beneficiary, unless the beneficiary rejected it promptly or within a specified period of time (e.g. 14 days). An alternative solution could be to treat silence and, possibly, partial or qualified acceptance as a rejection. For example, an amendment could be deemed to be rejected 21 days after its notification to the beneficiary unless the guarantor has received an unqualified acceptance from the beneficiary or has become aware of an act or conduct by the beneficiary in compliance with the terms of the amendment (e.g. submission of a required statement).

8. Another point in need of clarification is who exactly is covered by the term "beneficiary". As indicated in remark 6 to draft article 2 (A/CN.9/WG.II/WP.67), the original guaranty letter may have a number of beneficiaries, in particular in the practice of financial stand-by

letters of credit. As regards amendments that come into play at a later stage yet other beneficiaries may have to be recognized, namely substitute beneficiaries and beneficiaries by operation of law. The substitute beneficiary is found in stand-by letters of credit as a replacement of the original beneficiary when the latter resigns or is removed by the represented beneficiaries, usually the holders of debt or equity securities. This substitution must meet the terms and conditions of the stand-by letter of credit, and compliance with those terms must be ascertained by documentary means. The transferee by operation of law is associated with transfers decreed by statutory, administrative or decisional law in instances where the original beneficiary is insolvent or incapable of acting as a beneficiary. The Working Group may wish to decide whether in any rule requiring the beneficiary's consent those special categories of substitutes or transferees should be expressly mentioned or whether general rules of interpretation would lead to the conclusion that they were covered as well.

9. The above list of parties in UCP whose consent is required does not include the principal or, as the UCP calls it, the applicant for the credit. In contrast, section 5-106 (2) of the Uniform Commercial Code (UCC) provides: "Unless otherwise agreed once an irrevocable credit is established as regards the customer it can be modified or revoked only with the consent of the customer and once it is established as regards the beneficiary it can be modified or revoked only with his consent." It may be noted that the Task Force on the Study of UCC Article 5 recommended that the provision should be changed so as not to require the principal's consent.

10. Support for requiring the principal's consent may stem from a concern about the principal's interest in protecting its relationship with the guarantor against interference by third persons as well as the principal's possible desire not to have its name connected with the amended guaranty letter.

11. The main reason for excluding the principal from the list of parties whose consent is required is the independence of the guarantor's undertaking, i.e., the guarantor's undertaking creates a legal relationship only between it and the beneficiary. The consent of the principal to the amendment is relevant to a separate legal relationship, namely that between guarantor and the principal. Accordingly, the guarantor is free to modify its undertaking to the beneficiary without the principal's consent and is bound by the amended undertaking, but it does so at the risk of prejudicing its claim for reimbursement from the principal, depending on the instructions or the terms of the reimbursement agreement between the principal and the guarantor. Consideration might be given to drawing attention to the fact that the principal's consent may well be required under the legal relationship between the principal and the guarantor, by adding to the rule requiring the consent only of the guarantor and the beneficiary such wording as: "This provision does not excuse the failure to obtain the principal's consent, as it may be required by the agreement or instructions between the principal and the guarantor".

²ICC Publication No. 400, reproduced in A/CN.9/251.

B. Form of amendment

12. As regards requirements of form for an amendment to be effective, one approach would be to require the same form as provided for in draft article 7(1) for the establishment of the original guaranty letter (A/CN.9/WG.II/WP.67), subject to any special stipulation in the guaranty letter concerning the form of amendments (see paragraph 15 below). This approach could be based on the view that an amendment constitutes a part of the guaranty letter and as such shares the legal nature and characteristics, including evidentiary value, of the guaranty letter.

13. However, one may also point out that an amendment constitutes but a small part of the terms and conditions of the guaranty letter and that current amendment practice tends to be less formal. It was reported at the thirteenth session that there existed a practice under which an amendment of a written guaranty letter might be made orally and authenticated in that form; while the amendment would then be confirmed by a message that provided a record of the agreement, the oral communication was in practice regarded as determining the point of time of effectiveness of the amendment (A/CN.9/330, para. 106).

14. If the Working Group wished to accommodate this and similar informal practices, it might consider not requiring any particular form but requiring authentication of the source of an amendment. The same requirement of authentication of source, which would include signature, would seem appropriate if the Working Group were to decide in respect of draft article 7(1) not to require any particular form for the establishment of the guaranty letter. If such a provision requiring merely authentication were to be adopted for the establishment or amendment of the guaranty letter and the uniform law was eventually incorporated into a convention, consideration might be given to adding a provision along the lines of article 12 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980; hereinafter referred to as "United Nations Sales Convention").

15. While it is conceivable that prior to the establishment of the guaranty letter the guarantor and the beneficiary would have agreed on the required form of the guaranty letter, a stipulation on the required form for later amendments is more likely to exist. Thus, any general rule on form as discussed above would have to be made subject to contrary stipulation. For the sake of clarification, one might include a provision to the effect that the guaranty letter may not be amended other than in the stipulated form (along the lines of article 29(2) United Nations Sales Convention). Consideration might be given to adopting also the last sentence of that paragraph, which reads: "However, a party may be precluded by his conduct from asserting such a provision to the extent that the other party has relied on that conduct." The underlying principle appears to be equally appropriate in the context of guarantee and credit practice, even though in the context of a sales transaction there may be more instances of conduct on which reliance is placed that deserves to be protected.

C. Time of effectiveness

16. The point of time when an amendment becomes effective could be the same as that provided in draft article 7(2) for the establishment of the guaranty letter. However, in view of the required consent of the beneficiary, that result would be less appropriate if Variant B of draft article 7(2), using the time of issue as the time of effectiveness, were to be chosen (A/CN.9/WG.II/WP.67). Even Variant A, using the time of receipt by the beneficiary, might need some qualification.

17. For example, if an amendment would be deemed to be rejected unless accepted in full within a specified period of time, the determining point of time of effectiveness could be the time when the guarantor receives notice of the acceptance. If the opposite solution were to be adopted, namely that there was a presumption in favour of acceptance, the receipt of the amendment by the beneficiary might be appropriate as the determining time, even though its effectiveness might be subject to a rejection or qualified acceptance within the specified period of time. The use of the beneficiary's receipt of the amendment as the determining point of time could also accommodate the practice reported at paragraph 13 above that an oral amendment with authentication as to source would be effective even though a formal confirmation may be required or, at least, suggested by sound banking practice.

II. TRANSFER OF RIGHTS AND ASSIGNMENT OF PROCEEDS

18. The Working Group may wish to consider whether the uniform law should address the issue of the beneficiary's transfer of rights and assignment of proceeds. The use of the terms "transfer" and "assignment" is drawn from the UCP, which establish in article 54 a special legal regime for the transferable letter of credit and permit in article 55 the assignment of the proceeds of a credit. The term "assignment", which is used in the broader legal context to refer to a transfer of rights and obligations under a contract, is used in the UCP in the restricted sense of assignment of the proceeds. A change of the holder of the right to claim payment is referred to as "transfer". The UCP provisions on transferability require that the credit be expressly designated as "transferable" by the issuing bank, they require the consent of the bank requested to effect the transfer, whether or not it has confirmed the credit, and they permit only a single transfer of the credit.

19. The URG depart from the terminology and substance of the UCP provisions. Article 4 URG reads as follows: "The Beneficiary's right to claim under a Guarantee is not assignable unless expressly stated in the Guarantee wording itself or in an amendment thereto. This article shall not, however, affect the Beneficiary's right to assign any proceeds to which he may be, or may become, entitled under the Guarantee." Only the term "assignment" is used and, while the UCP distinction between the claim and the proceeds is maintained, no mention is made of a limit on the number of possible transfers.

20. If the Working Group were to decide that the uniform law should contain provisions on transfer of rights and on assignment of proceeds, it might wish to consider the following points concerning the mechanics and consequences of a transfer and of an assignment. As regards assignment of proceeds, it might be useful to clarify that the object of an assignment is merely the proceeds, i.e. any funds that will be forthcoming when the guarantor honours its payment obligation. Accordingly, the assignee is not entitled to claim payment or to present any statement or document that may be required in order to claim payment, since that may change the risk to which the principal and the guarantor have agreed to be exposed. The position of an assignee is thus weaker than that of a transferee in that a beneficiary, having obtained funds from the assignee in exchange for the assignment, would be able to block payment to the assignee by not submitting a claim for payment. Another clarification could be to require a notice of assignment from the beneficiary to the guarantor, or possibly even a notice of acknowledgement by the guarantor, so as to create certainty as to whom the guarantor is supposed to pay and thereby discharge its payment obligation under the guaranty letter. Yet another issue that might be addressed is whether only one assignment of the proceeds should be allowed and whether such an assignment should have to be of 100 per cent of the proceeds.

21. As regards the possible transfer of the beneficiary's right to claim payment, two special features of independent guarantees and stand-by letters of credit need to be taken into account when formulating appropriate rules in view of the different interests involved. Firstly, where a guaranty letter is given in support of an underlying obligation of the principal, the true beneficiary should be the one to whom performance of that underlying obligation is owed and who is in a position to declare, or submit documents establishing, default. While the guarantor does not usually judge the reliability of the beneficiary before issuing its guaranty letter, it is expected to bear in mind the interest of the principal, who usually has judged the reliability of the beneficiary before establishing its relationship with the beneficiary. In this vein, a transfer of the beneficiary's right to demand payment makes sense where the creditor to the underlying obligation has changed.

22. A second special feature becomes apparent in comparison with a traditional commercial letter of credit. There "only the original beneficiary, if it is a non-transferable credit, or the second beneficiary if the credit is transferable, is entitled to tender the documents that will prompt the issuing bank's payment. Yet, where a bank issues a financial standby promising to pay the beneficiary and the holder of the unpaid promissory note, draft or demand for payment, the bank also extends the promise to receive the tender of documents to whomever the original beneficiary transfers the note, draft or demand for payment and accompanying documents, if any. This differs from the promise in the circular-negotiation type of commercial letter of credit (whose language of negotiation, incidentally, is none the less usually incorporated in the text of the financial standby) because the negotiation contemplated in the circular commercial letter of credit is of the draft only. It does not presuppose the transfer of the

right to tender the documents that comply with the text of the credit, a right which, most often, is exercised by the beneficiary prior to negotiating the draft."³

23. These two special features may be taken as suggesting the following conclusions. The beneficiary should not be free to transfer its right to payment whenever it so wishes; it may do so only if permitted under the guaranty letter and thus presumably with the principal's consent. The above description of a financial stand-by letter of credit suggests, however, that a requirement such as express statement or express designation as "transferable" would be too narrow. One might even view the transfers envisaged in such an undertaking as expected changes of the individuals covered by the original undertaking and not as transfers in the technical sense of the term. Yet another conclusion might be that more than a single transfer should be permitted if so stipulated in the guaranty letter. Finally, consideration may be given to clarifying, in the absence of a clear answer in the guaranty letter, whether only the transferee is entitled to claim payment and present any required statement or document or whether the transferor, i.e., the original beneficiary, is supposed to do so on the transferee's account.

III. EXPIRY

24. Certainty about the expiry of the guaranty letter is at least as important as certainty about the time when the guaranty letter becomes effective (see draft article 7(2), A/CN.9/WG.II/WP.67). The uniform law might help to enhance certainty in two respects. It could clarify the meaning and effect of expiry as stipulated in the guaranty letter, and it could address various issues relating to party autonomy in stipulating expiry terms.

A. Meaning and effect

25. A stipulation that the guarantee or stand-by letter of credit expires on a given date is widely understood to mean that a demand for payment, accompanied by any required documents, may be made only before or on that date and that, accordingly, the guarantor is not obliged to pay upon any demand made after that date. However, courts of some jurisdictions have given a different interpretation, namely that merely the contingency for which the guarantee had been given must have occurred before or on the expiry date, and have recognized a demand for payment made after that date, either within a reasonable time thereafter or even during a period of limitation or prescription, which may extend long after the expiry date.

26. The uniform law might usefully clarify matters by prescribing the first interpretation, as is done in a number of national laws. For example, the 1963 International Trade Code of Czechoslovakia provides in section 671:

³Kozolchyk, *The Emerging Law of Standby Letters of Credit and Bank Guarantees*, 24 Arizona L.R. (1982), 319, 356.

"If the validity of the banking guaranty is limited in time, the entitled person shall notify the bank of his claims not later than within such time; otherwise his claims under the banking guaranty shall be extinguished."⁴

27. Very similar provisions are found in the laws of Bahrain,⁵ Iraq⁶ and Kuwait. For example, the 1980 Commercial Law of Kuwait provides in article 386:

"The bank shall be discharged of liability *vis-à-vis* the beneficiary if within the validity period of the letter of guarantee no request for payment is received from the beneficiary, unless it had been expressly agreed to renew said term prior to its expiry."⁷

28. As regards uniform rules, the same interpretation of expiry appears in the last sentence of article 22 URG ("Claims received after the Expiry Date or Expiry Event shall be refused by the Guarantor") and in article 19 URG:

"A claim shall be made in accordance with the terms of the Guarantee on or before its expiry and, in particular, all documents specified in the Guarantee for the purpose of claiming shall be presented to the Guarantor on or before its expiry at its place of issue, otherwise the claim shall be refused."

29. If the Working Group were to adopt a provision in support of the first interpretation, i.e., that the claim for payment must be made within the validity period, an exception might have to be made where the expiry clause in the guaranty letter provides otherwise (e.g., undertaking to pay in the event of the principal's default within a definite period of time). A possible solution for that exception might be to grant additional time, either a fixed or a reasonable period, for submitting the demand and the required documents. The same should probably apply where a counter-guarantor promises to indemnify the guarantor for any payment made before the expiry of its guaranty letter, provided the counter-guaranty letter contains no other expiry clause, such as a specific expiry date. Here, as in any other case, each guaranty letter stands on its own as regards its time of effectiveness and expiry.

30. The effect of expiry that payment may no longer be demanded has been described in the above sample provisions (paragraphs 26-28) by such expressions as "claims shall be extinguished", "bank shall be discharged of liability *vis-à-vis* the beneficiary", and "claim shall be refused". A provision to that effect in the uniform law could enhance certainty by making it clear that the effect of expiry does not depend on any further act such as return of the guaranty letter or a declaration of release by the beneficiary. It is submitted that such an automatic effect should obtain even where a clause in the guaranty letter requires the return of the instrument or a declaration of

release. As regards the issue of the return of the instrument, article 24 URG provides:

"Where a Guarantee has terminated by payment, expiry, cancellation or otherwise, retention of the Guarantee or of any amendments thereto shall not preserve any rights of the Beneficiary under the Guarantee."

31. Such a rule is useful in that it prevents uncertainty and the risk of everlasting enforceability. It takes into account that there are various possible reasons for retaining the guaranty letter and that the very idea of return or retention is becoming less applicable in the context of modern means of communication. Above all, it helps to dispel the misconception that the guaranty letter would be an instrument that, as a negotiable instrument does, carried in it the right to payment so as to require possession and presentment of the instrument for the enforcement of that right. The advantage of having in the uniform law a provision along the lines of article 24 URG would be that the uniform law, unlike uniform rules that become effective by agreement, would make inapplicable any contrary provision of law in the State enacting the uniform law.

32. It is doubtful whether the same need exists for incorporating in the uniform law a provision along the lines of article 23 URG, which also touches on the issue of return or retention in dealing with pre-expiry events that free the guarantor from liability and thus make expiry obsolete:

"Irrespective of any expiry provision contained therein, a Guarantee shall be cancelled prior to the Expiry Date or Expiry Event on presentation to the Guarantor of the Guarantee itself or the Beneficiary's authenticated statement of release from liability under the Guarantee, whether or not the Guarantee or any amendments thereto are returned."

33. If a provision along those lines were to be included in the uniform law, the Working Group may wish to consider the following two points. Firstly, the expression "shall be cancelled" might be reworded so as to make clear that the effect is automatic and does not depend on any further act or declaration. Secondly, it might be too rigid to attach the effect of cancellation to the "presentation to the Guarantor of the Guarantee itself" in that it could be construed as extending beyond those cases where the presentation constitutes an implied release or waiver and, for example, covering the case of an erroneous return.

B. Party autonomy and possible limits

34. The preceding discussion of the meaning and effect of expiry assumed the existence of a valid expiry clause. An expiry clause may be found in the guaranty letter or, in particular where the validity period has been extended, in an amendment to the guaranty letter (as discussed above, paragraphs 3-17; it may be noted that the Secretariat intends to discuss the problems surrounding so-called "extend or pay" demands in a future note). To be discussed now are two issues relating to party autonomy

⁴Act No. 101 (of 4 December, 1963) on Legal Relations arising in International Business Transactions, see Introduction and Commentary by Kopac (Prague 1967), p. 201.

⁵Art. 335(1) of the Commercial Code of Bahrain, Law No. 7 of 1987.

⁶Art. 291(1) of the Commercial Code of Iraq, Law No. 30 of 1984.

⁷Decree No. 68 of 1980 Enacting the Law of Commerce of Kuwait.

in stipulating expiry clauses. The first issue concerns the modalities of determining the time of expiry, in particular the reference to an expiry event rather than an expiry date. The second issue is whether a guaranty letter must contain an expiry clause and, if so, what the sanction for failure should be. In this context it will be asked whether the uniform law should provide for a cut-off period and, if so, what its legal character should be.

(1) Modalities of determining the time of expiry

35. The time of expiry may be fixed in a number of ways. The most certain way is to fix a calendar date. Another way is to state a definite period of time (e.g. six months). Since some uncertainty might exist as to the exact starting point of that period of time, the uniform law might help by referring to the time of effectiveness (according to draft article 7(2); A/CN.9/WG.II/WP.67). Yet another way is to specify a certain act or event (e.g. completion of principal's performance, acceptance of works by beneficiary, award of contract to another tenderer). Expiry clauses of that kind may create problems in two respects.

36. Firstly, where expiry is linked to an event, the guarantor would have to engage in an undesirable examination of facts and might become entangled in a dispute between the beneficiary and the principal. Since the deliberations of the Working Group on the so-called non-documentary payment conditions (A/CN.9/330, paras. 68-75) seem applicable here, consideration may be given to converting any non-documentary expiry that is not readily determinable by the guarantor into a documentary one. The documentary approach is taken by article 22 URG (first sentence) which appears to qualify the presentation of documents itself as expiry event:

"Expiry of a Guarantee for the presentation of claims shall be upon a specified calendar date ('Expiry Date') or upon presentation to the Guarantor of the document(s) specified for the purpose of expiry ('Expiry Event')."

37. Secondly, expiry that is linked to an event may never occur or at least not for a long time. Even where presentation of a document is required, there may be a risk of an everlasting undertaking, at least if the document is to be furnished by the beneficiary. The most effective cure would be not to recognize expiry clauses based on an event and thus to allow only the specification of a calendar date or a definite period of time. However, that cure might be regarded as too rigid. Another cure might be provided by the cut-off period discussed below (paragraphs 42-43) or, for certain extreme cases, by provisions dealing with fraud or manifest abuse (to be discussed in a future Secretariat note).

(2) Possible requirement of an expiry clause and possible cut-off period

38. The Working Group may wish to consider whether the uniform law should require guaranty letters to contain an expiry clause and, if so, what the consequence of a lack

of such a clause should be. It may be noted that the URG appear not to require an expiry clause and do not provide for any sanction in case of failure to contain such a clause. While article 22 URG (quoted above, paragraph 36, in its essential part) might be read as requiring an expiry date or expiry event, article 3(f) URG takes a hortatory approach by stating that "all guarantees should stipulate the expiry date and/or expiry event of the Guarantee".

39. Expiry clauses might be missing in guaranty letters due to omission or oversight. Even where they are intentionally left out, the result is at least uncertainty and possibly an undertaking of indeterminate effectiveness or perpetual enforceability. As was noted at the thirteenth session (A/CN.9/330, paras. 24 and 44), perpetual undertakings may be regarded as unsettling and commercially undesirable. They may raise regulatory concerns in view of the continuing risk exposure, and they may lead to increased costs under the capital adequacy rules of the Basel Agreement. Finally, they create uncertainty in that they might be affected by a period of limitation or prescription of an applicable law which in itself might be difficult to determine. It may be added that this uncertainty is aggravated by the following disparities between national laws of limitation or prescription: limitation periods vary considerably and may be as long as 30 years; limitation periods may commence to run at the establishment of the guaranty letter, the occurrence of the secured contingency or the time of the demand; limitation periods may or may not be shortened by the parties; foreign guaranty letters may or may not be subjected to domestic limitation periods.

40. The following reasons may be advanced against requiring an expiry clause. Since undertakings that do not specify a period of effectiveness are found in practice, the uniform law should not attempt to change that practice. Concerns relating to undertakings of indeterminate validity are not primarily due to the lack of an expiry clause since the same objections could be raised against clauses providing for perpetual or very long validity.

41. If the Working Group were to decide in favour of requiring an expiry clause, it would have to decide what the consequence of a lack of expiry clause should be. One possible sanction would be to treat the guaranty letter as invalid or ineffective. However, that sanction would probably be too extreme.

42. A more acceptable solution, as suggested during the thirteenth session of the Working Group (A/CN.9/330, paras. 25 and 46), would be to provide for a cut-off period of, say, five years. The cut-off period would apply only if the guaranty letter or an amendment thereto were not to contain an expiry clause. Due to its supplementary character, it would not prevent the stipulation of a longer period of effectiveness.

43. However, that solution would not meet the above concerns relating to undertakings of perpetual or excessively long validity. Consideration might thus be given to providing that the cut-off period may not be derogated from. If the cut-off period were to be mandatory, it should probably be longer than if it were to be supplementary

(e.g. 10 years). Whether mandatory or not, the cut-off period should be given the meaning and effect discussed above (paragraphs 25-33).

IV. OBLIGATIONS OF GUARANTOR

44. The following discussion deals with the most crucial situation in a guaranty letter transaction, i.e., when the beneficiary demands payment. It focuses on various issues relating to the obligations of the guarantor and is meant to include the counter-guarantor and the confirming guarantor. In considering those issues, a recurrent question will be whether they should be addressed in provisions of the uniform law and, if so, whether the provisions should be of mandatory or supplementary character. The question seems particularly pertinent in respect of issues on which rules are provided in the URG.

A. Obligation to pay upon conforming demand

45. As suggested in draft article 2 (A/CN.9/WG.II/WP.67), the guarantor is obliged to pay "in conformity with the terms of the undertaking". Upon receipt of a demand for payment, the guarantor would thus examine its conformity with the terms of the guaranty letter. It may be noted that a future Secretariat note will discuss possible grounds for refusing payment that are not instances of non-conformity (e.g. fraud, manifest abuse).

46. The points that the recipient of a claim would have to verify in order to decide whether it is obliged to pay under the guaranty letter may be illustrated by the following list:

Timeliness, i.e., the claim is not made after expiry

Proper claimant, i.e., the person demanding payment is the beneficiary designated in the guaranty letter

Proper form, i.e., the claim meets any requirement of form laid down in the guaranty letter or in the applicable law

Proper addressee and place of presentment, i.e., payment is demanded from the obliged party (e.g. guarantor, but not the advising bank) and the claim is presented at the right place in respect of that party (e.g. issuing bank or confirming bank)

Appropriate amount, i.e., the amount claimed does not exceed the maximum amount as stated in the guaranty letter or as reduced either by a previous payment or according to an express reduction clause

Fulfilment of payment conditions, i.e. presentment of specified documents or fulfilment of other requirements upon which payment is predicated

47. As regards the proper form of the demand, the Working Group may wish to consider whether the uniform law itself should contain any requirement as to form and, for example, whether it should exclude purely oral demands.

48. The Working Group may wish to consider whether the uniform law should contain a provision on the proper place. The rule in article 19 URG that a claim under the guarantee shall be made "at the place of its issue" might be refined so as clearly to link presentment to the particular addressee, e.g. confirming instead of issuing bank, and to give effect to any stipulation of a different place of presentment.

(1) Standard of examination as to conformity

49. Article 9 URG provides:

"All document(s) specified and presented under a Guarantee, including the claim, shall be examined by the Guarantor with reasonable care to ascertain whether or not they appear on their face to conform with the terms of the Guarantee. Where such document(s) do not appear so to conform or appear on their face to be inconsistent with one another, they shall be refused."

50. It is primarily in the context of verifying payment conditions that the standard of examination for facial conformity comes into play. Even where payment depends on the occurrence of an event and that occurrence is not within the guarantor's purview, an examination of documents would be required if the uniform law would incorporate the prevailing view at the thirteenth session (A/CN.9/330, para. 75) that non-documentary payment conditions should be converted into documentary ones obliging the beneficiary to submit a statement affirming the occurrence of the event in question or a certificate of an appropriate third person.

51. The standard of facial compliance may also play a role in the examination of other points included in the above illustrative list (paragraph 46). For example, where expiry is linked to an event, verification of timeliness may involve examination of documents, in particular if the uniform law were to adopt the documentary approach suggested above (paragraph 36). Similarly, where a reduction clause refers to an event, determination of the appropriate amount may involve examination of documents, in particular if the uniform law were to require that, as suggested at the thirteenth session (A/CN.9/330, para. 22), the available amount be readily determinable by the guarantor, for example, on the basis of clearly specified documents.

52. The Working Group may wish to consider whether a rule such as the one in article 9 URG would be appropriate for the uniform law and whether it should be refined or supplemented. In doing so, the Working Group may build on its discussion of the thirteenth session relating to the doctrine of strict compliance and to the possible use of the understanding and established practices of bankers as a criterion of the standard of construction and care (A/CN.9/330, paras. 86-91).

53. As was noted at the thirteenth session, the term "strict compliance", as distinguished from "substantial

compliance", could be understood as meaning true strictness down to the comma or it could be understood as allowing a marginal latitude to correct typographical errors or similar minimal deviations. In fact, there exists no uniform understanding, and the handling of discrepant documents in letter of credit practice appears to be a primary source of disputes and litigation.

54. In considering whether a rigid or a more flexible standard of compliance would be appropriate, account should be taken of certain differences between the commercial letter of credit and the guaranty letter. Firstly, the commercial letter of credit provides a secured payment mechanism likely to be utilized in the ordinary course of the transaction, while the guaranty letter is designed to indemnify the beneficiary for the consequences of a contingency that is unlikely to occur. Secondly, the documents tendered under a commercial letter of credit (e.g. bill of lading) are likely to be merchantable, while the statements or documents required under a guaranty letter are rarely of such type. Thirdly, the documents required under a commercial letter of credit tend to be more standardized than those required under a guaranty letter, and they are explained and regulated in detail by the UCP.

55. The following three examples might help to assess the possible role of the standard of facial compliance in guaranty letter practice:

(A) A financial stand-by letter of credit contains in its annex the text of three statements describing the possible contingencies for which the undertaking is given and leaving blanks for the amount to be filled in by the beneficiary.

(In such case, the well-known maxim of the doctrine of strict compliance is clearly applicable: There is no room for documents that are almost the same, or that will do just as well.)

(B) A tender guarantee is payable on first demand accompanied by a written statement of the beneficiary certifying that the tenderer did not honour its commitment. The beneficiary sends the following facsimile message to the guarantor: "We hereby demand payment of 125.000 USD, confirming Company X did not sign awarded contract. Signed B." The guarantor refuses to pay because the beneficiary's statement contained neither the word "certify" nor the words "did not honour its commitment".

(However one may judge the reasons given for rejecting the claim, it is submitted that this case illustrates the limitations of the doctrine of strict compliance, whether or not interpreted in its literal, rigid sense.)

(C) A performance guarantee states that it is payable on simple demand and that it is subject to the URG. The beneficiary supports its demand by a declaration to the effect that the principal defaulted on its obligations, in particular, its main obligations under the contract. The principal instructs the guarantor not to pay because the beneficiary did not state, as required under

article 20 (a)(ii) URG, "the respect in which the Principal was in breach".⁸

(This latter wording, which may equally be found in an individually drafted text of a guaranty letter, exemplifies the frequent vagueness of the description of the required contents of a statement by the beneficiary and, in turn, of the limited utility of a standard based on strict compliance. In determining the conformity of a statement with the requirements contained in the guaranty letter, construed in accordance with draft article 6 of the uniform law, a process of interpretation and judgment is needed that cannot be appropriately covered by a single term such as "strict compliance", and probably also not "substantial compliance".)

56. One conclusion would be that it is primarily for the parties to provide greater certainty by formulating precise requirements, illustrated in the first example. As regards the uniform law, a standard of facial compliance, however strict or flexible it may be, might have less significance than the standard of reasonable care in examining the conformity of the claim, including any required documents, with the terms of the guaranty letter.

57. In this connection consideration may be given to refining the standard of care, for example, by referring to the understanding of a reasonable and experienced documents checker. Such refinement might help to prevent an overly rigid attitude towards conformity where a process of interpretation and judgement is needed. However, one might regard such refinement as unnecessary in view of the fact that any legal standard of care tends to be judged with regard to the relevant group of persons and that the uniform law may be expected to include the mandatory requirement that guarantors act in good faith and with reasonable care (as provided in the new version of article 15 URG; see paragraphs 67-68 below).

(2) Time allowed for examination

58. Article 10(a) URG provides:

"A Guarantor shall have reasonable time in which to examine a claim under a Guarantee and to decide whether to pay or to refuse the claim."

59. Except for minor drafting changes, this provision corresponds with the previous version which the Working Group reviewed at its twelfth session (A/CN.9/316,

⁸Article 20 (a) URG reads: "Any claim for payment under the Guarantee shall be supported by a written statement (whether in the claim itself or in a separate document or documents accompanying the claim and referred to in it) stating:

(i) that the Principal is in breach of his obligation(s) under the underlying contract(s);
and
(ii) the respect in which the Principal is in breach."

(Article 20 (c) URG reads: "This Article applies except to the extent that it is expressly excluded by the terms of the Guarantee or Counter-Guarantee.")

paras. 50-51). As was then noted in favour of retaining the notion of "reasonable time", the notion is well known, in particular from article 16(c) UCP, and takes into account differences in circumstances found in individual cases as well as regional and national variations in practice.

60. However, such flexibility is necessarily coupled with uncertainty that might not be desirable in international practice. With a view to achieving certainty, various proposals were made concerning inclusion of a definite period, e.g. five days or, as provided by section 5-112(1)(a) UCC, three days. One compromise suggestion was to use a rebuttable presumption of a certain fixed length of time as appropriate, unless agreed or proven otherwise, with the burden being on the party alleging its reasonableness.

B. Duties of notification

61. The Working Group may wish to consider whether the uniform law should oblige the guarantor, upon receipt of a claim, to inform the principal or instructing party thereof.⁹ It may also wish to consider the time and modalities of the notice to the beneficiary that the guarantor would be obliged to give if it rejected the claim. Both duties are laid down in provisions of the URG (which in an earlier, somewhat different version were reviewed by the Working Group at its twelfth session, A/CN.9/316, paras. 50, 52, 72-75):

Article 10(b)

"If the Guarantor decides to refuse a claim, it shall immediately give notice thereof to the Beneficiary by teletransmission or, if that is not possible, by other expeditious means. Any documents shall be held at the disposal of the Beneficiary."

Article 17

"Without prejudice to the terms of Article 10, in the event of a claim the Guarantor shall without delay so inform the Principal or where applicable its Instructing Party and in that case the Instructing Party shall so inform the Principal."

62. With respect to the provision on notice of rejection, the Working Group suggested at its twelfth session that the notice should include a statement of the reasons for the rejection since a beneficiary, if informed of the nature of a documentary discrepancy, might be in a position to cure the discrepancy and resubmit the document in question. A consequential proposal was that the provision might include a rule of preclusion, perhaps similar to the one contained in article 16 UCP, thereby limiting the right of a guarantor to reject a submission of documents on the basis of discrepancies that could or should have been notified to a beneficiary during an earlier submission (A/CN.9/316, para. 52). It may be added

that a rule of preclusion that was closely modelled on article 16(e) UCP would have the further consequence of precluding a guarantor who failed to examine the documents within the required period of time from claiming that they were not in accordance with the terms and conditions of the guaranty letter. The rule of preclusion would thus provide the sanction for failure to comply with the rule on the time for examination discussed above (paragraphs 58-60).

63. As regards the guarantor's duty to inform the principal or instructing party in the event of a claim, it is likely to be controversial in principle and to create difficulties in its implementation, in particular with respect to the guarantor's duty to pay upon a conforming demand. For example, questions were raised at the twelfth session as to whether notice should be given prior to payment, or whether payment could validly be made without notice and whether the notification, if made prior to payment, should contain information concerning the guarantor's intention to honour or dishonour the claim. In considering these and other questions relating to this duty, the Working Group may wish to take into account the opening words that were added to the new version of article 17 URG: "Without prejudice to the terms of Article 10", i.e. the provisions on the time for examination and on the duty to give notice of rejection.

64. Finally, the Working Group may wish to consider whether the uniform law should deal with further duties of notification. For example, consideration might be given to requiring financial institutions that receive a request for issuing a counter-guaranty letter or for confirming or advising a guaranty letter and that elect for any reason not to comply with such request to so inform the requesting party within a specified time, e.g. five days, after the receipt of the request.

V. LIABILITY AND EXEMPTION

65. The Working Group may wish to consider whether the uniform law should contain provisions on the liability of guarantors and, possibly, instructing parties. It may use as a basis of its discussion the pertinent URG provisions, an earlier version of which it reviewed at its twelfth session (A/CN.9/316, paras. 53-69). The relevant provisions of URG are:

Article 11

"Guarantors and Instructing Parties assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification, or legal effect of any document presented to them or for the general and/or particular statements made therein, or for the good faith or acts and/or omissions of any person whomsoever."

Article 12

"Guarantors and Instructing Parties assume no liability or responsibility for the consequences arising out of

⁹As to the term "instructing party", see draft article 2, A/CN.9/WG.II/WP.67.

delay and/or loss in transit of any messages, letters, claims or documents, or for delay, mutilation or other errors arising in the transmission of any telecommunication. Guarantors and Instructing Parties assume no liability for errors in translation or interpretation of technical terms and reserve the right to transmit Guarantee texts or any parts thereof without translating them."

Article 13

"Guarantors and Instructing Parties assume no liability or responsibility for consequences arising out of the interruption of their business by acts of God, riots, civil commotions, insurrections, wars or any other causes beyond their control or by strikes, lock-outs or industrial action of whatever nature."

Article 14

(a) "Guarantors and Instructing Parties utilizing the services of another party for the purpose of giving effect to the instructions of a Principal do so for the account and at the risk of that Principal."

(b) "Guarantors and Instructing Parties assume no liability or responsibility should the instructions they transmit not be carried out even if they have themselves taken the initiative in the choice of such other party."

(c) "The Principal shall be liable to indemnify the Guarantor or the Instructing Party, as the case may be, against all obligations and responsibilities imposed by foreign laws and usages."

Article 15

"Guarantors and Instructing Parties shall not be excluded from liability or responsibility under the terms of Articles 11, 12, and 14 above for their failure to act in good faith and with reasonable care."

66. The discussion may conveniently be divided into two parts, dealing first with issues addressed in article 15 URG, the only provision imposing liability, and then with issues raised by articles 11 to 14 URG, which, while presented in the URG under the heading "Liabilities and responsibilities", contain in substance exemption clauses.

A. Liability and standard of care

67. It may be recalled that the previous version of article 15 URG imposed liability on guarantors and instructing parties "for their grossly negligent or willful acts". The new basis of liability, "failure to act in good faith and with reasonable care", reflects the view widely supported in the Working Group that guarantors and instructing parties should exercise reasonable care in performing their obligations (A/CN.9/316, para. 69).

68. A provision in the uniform law along the lines of article 15 URG would have a different legal character and possibly a different scope. Article 15 URG limits the effect of exemption clauses contained in the same set of rules, all of which, including article 15, become effective by agreement of the parties and may thus be excluded or varied. The uniform law, however, would be in a position to impose liability in a mandatory fashion. Thus it could effectively limit any exemptions from such liability, whether they be found in individually drafted clauses of guaranty letters or in general conditions or uniform rules referred to in guaranty letters.

B. Exemptions from liability

69. As regards articles 11 to 14 URG, the current provisions are essentially the same as those reviewed by the Working Group at its twelfth session. It may be recalled that serious objections were raised, in particular, in respect of articles 12 to 14 URG which were regarded as unduly favouring guarantors and instructing parties. Suggestions were made that those exempting provisions should be deleted or drafted in a more balanced manner.

70. It was pointed out in response that the provisions were closely modelled on articles 17 to 20 UCP which had not given rise to difficulties. As regards the exemption for *force majeure* it was stated that guarantee texts often contained *force majeure* clauses and that even without any contractual exemption a similar result would obtain from the applicable national law. However, since national laws differed as to the scope of exempting impediments, it might be desirable to strive for a greater degree of harmony.

71. In discussing whether the uniform law should include any of the exemptions contained in articles 11 to 14 URG, the Working Group may wish to take into account the following considerations based on differences between the URG and the uniform law. While the future acceptability of the text to bankers as the primarily concerned persons will be an important factor in a State's decision about the acceptance of the uniform law, that may be less so in respect of exemption clauses since these are more commonly promulgated by the interested circles, for example, in general conditions.

72. Moreover, the need for including in the uniform law provisions on exemption appears to be reduced by the very fact that the URG contains exemption clauses. Finally, exemption clauses seem to be more appropriate in a text that itself spells out the various obligations, the breach of which raises the question of liability and exemption therefrom. There may thus be less need for including exemption clauses in the uniform law, which, whatever its final coverage will be, is certain to contain fewer "rules of traffic" and provisions imposing duties than the URG.

**C. Report of the Working Group on International Contract
Practices on the work of its fifteenth session
(New York, 13-24 May 1991) (A/CN.9/345) [Original: English]**

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INTRODUCTION

1. Pursuant to a decision taken by the Commission at its twenty-first session,¹ the Working Group on International Contract Practices devoted its twelfth session to a review of the draft Uniform Rules on Guarantees being prepared by the International Chamber of Commerce (ICC) and to an examination of the desirability and feasibility of any future work relating to greater uniformity at the statutory law level in respect of guarantees and stand-by letters of

credit (A/CN.9/316). The Working Group recommended that work be initiated on the preparation of a uniform law, whether in the form of a model law or in the form of a convention.

2. The Commission, at its twenty-second session, accepted the recommendation of the Working Group that work on a uniform law should be undertaken and entrusted this task to the Working Group.²

3. At its thirteenth session (A/CN.9/330), the Working Group commenced its work by considering possible issues

¹Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), para. 22.

²Ibid., Forty-fourth Session, Supplement No. 17 (A/44/17), para. 244.

of a uniform law as discussed in a note by the Secretariat (A/CN.9/WG.II/WP.65). Those issues related to the substantive scope of the uniform law, party autonomy and its limits, and possible rules of interpretation. The Working Group also engaged in a preliminary exchange of views on issues relating to the form and time of establishment of the guarantee or stand-by letter of credit. The Working Group requested the Secretariat to submit to its fourteenth session a first draft set of articles, with possible variants, on the above issues as well as a note discussing other possible issues to be covered by the uniform law.

4. At its fourteenth session (A/CN.9/342), the Working Group examined draft articles 1 to 7 of the uniform law prepared by the Secretariat (A/CN.9/WG.II/WP.67). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a revised draft of articles 1 to 7 of the uniform law. The Working Group also considered the issues discussed in a note by the Secretariat relating to amendment, transfer, expiry, and obligations of guarantor (A/CN.9/WG.II/WP.68). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a first draft of articles on the issues discussed. It was noted that the Secretariat would submit to the Working Group, at its fifteenth session, a note on further issues to be covered by the uniform law, including fraud and other objections to payment, injunctions and other court measures, conflict of laws and jurisdiction.

5. The Working Group, which was composed of all States members of the Commission, held its fifteenth session in New York, from 13 to 24 May 1991. The session was attended by representatives of the following States members of the Working Group: Canada, Chile, China, Cyprus, Czechoslovakia, Egypt, France, Germany, India, Iran (Islamic Republic of), Iraq, Italy, Japan, Kenya, Libyan Arab Jamahiriya, Mexico, Morocco, Netherlands, Nigeria, Singapore, Spain, Togo, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay and Yugoslavia.

6. The session was attended by observers from the following States: Algeria, Australia, Austria, Bahamas, Brazil, Cape Verde, Colombia, Congo, Ecuador, Finland, Haiti, Honduras, Indonesia, Oman, Pakistan, Peru, Philippines, Poland, Romania, Rwanda, Saudi Arabia, Sweden, Switzerland, Thailand, Tunisia, Uganda, United Republic of Tanzania, Vanuatu, Venezuela, Viet Nam and Yemen.

7. The session was attended by observers from the following international organizations: Asian-African Legal Consultative Committee (AALCC), Hague Conference on Private International Law, International Monetary Fund (IMF), Banking Federation of the European Community, Cairo Regional Centre for International Commercial Arbitration, International Chamber of Commerce.

8. The Working Group elected the following officers:

Chairman: Mr. J. Gauthier (Canada)

Rapporteur: Mr. R. Sandoval (Chile).

9. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.69) and two notes by the Secretariat discussing further issues of a uniform law: fraud and other objections to payment, injunctions and other court measures (A/CN.9/WG.II/WP.70); conflict of laws and jurisdiction (A/CN.9/WG.II/WP.71).

10. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a uniform law on international guaranty letters.
4. Other business.
5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

11. The Working Group considered certain issues concerning the obligations of the guarantor. Those issues had been discussed in the note by the Secretariat relating to amendment, transfer, expiry, and obligations of guarantor (A/CN.9/WG.II/WP.68) that had been submitted to the Working Group at its fourteenth session but had not then been considered, for lack of time. The deliberations and conclusions of the Working Group are set forth below in chapter II. The Secretariat was requested to prepare, on the basis of those conclusions, a first draft set of articles on the issues discussed.

12. The Working Group then considered the issues discussed in the note by the Secretariat relating to fraud and other objections to payment, injunctions and other court measures (A/CN.9/WG.II/WP.70). The deliberations and conclusions of the Working Group are set forth below in chapters III, IV and V. The Secretariat was requested to prepare, on the basis of those conclusions, a first draft set of articles, with possible variants, on the issues discussed.

13. The Working Group also considered the issues discussed in the note by the Secretariat relating to conflict of laws and jurisdiction (A/CN.9/WG.II/WP.71). The deliberations and conclusions of the Working Group are set forth below in chapter VI. The Secretariat was requested to prepare, on the basis of those conclusions, a first draft set of articles on the issues discussed.

II. DISCUSSION OF CERTAIN ISSUES CONCERNING THE OBLIGATIONS OF THE GUARANTOR

14. The Working Group continued its deliberations on the obligations of the guarantor and considered the following issues which, for lack of time, it had not considered at its fourteenth session: time allowed for examination, duties of notification, and liability and exemption (as discussed in document A/CN.9/WG.II/WP.68, paras. 58-72).

A. Time allowed for examination

15. The Working Group noted that, under article 10(a) of the revised text of the ICC Draft Uniform Rules for Demand Guarantees³ (URDG), "a Guarantor shall have reasonable time in which to examine a claim under a Guarantee and to decide whether to pay or to refuse the claim". It was understood that, as expressed in that provision, the time accorded to the guarantor was for both related purposes, namely that of examining the claim and of deciding whether or not to pay.

16. There was considerable support for using in the uniform law the formula "reasonable time" as adopted in the above provision. It was stated that this formula was well known in banking practice and that it was sufficiently flexible to accommodate the varied circumstances of individual cases as well as regional or national variations in practice. However, there was some support for providing uniformity and certainty by fixing a number of working or banking days (e.g., three, five or seven). Yet another view was to combine both approaches by according the guarantor reasonable time up to a limit of seven days, as appears to be the currently suggested rule for the future revision of the ICC Uniform Customs and Practice for Documentary Credits (UCP). It was stated in reply that such an upper limit might eventually be regarded as the regular time period and that it might thus extend the time period beyond what is currently the practice, i.e., about three days.

17. The Working Group was agreed that the future provision in the uniform law on the time allowed for examination should not be mandatory. That would permit derogation either by incorporation of rules such as those contained in URDG or UCP or by stipulating a different period of time in the particular guaranty letter.

B. Duties of notification

18. The Working Group considered, on the basis of the discussion set forth in document A/CN.9/WG.II/WP.68 (paras. 61-64), whether the uniform law should contain provisions concerning notice to the principal of a claim, notice to the beneficiary of the rejection of its claim and possible further notifications by financial institutions.

Notice to the principal of a claim

19. It was noted that the issue of notice to the principal was dealt with in draft article 17 URDG in the following way:

"Without prejudice to the terms of article 10,⁴ in the event of a claim the Guarantor shall without delay so inform the Principal or where applicable its Instructing Party and in that case the Instructing Party shall so inform the Principal."

20. It was further noted that draft article 17 URDG was apparently not designed to address the problem of "extend or pay" requests since these were dealt with elsewhere, namely, in draft article 26 URDG. It was stated that a rule such as the one contained in draft article 17 URDG would be inconsistent with the practice of stand-by letters of credit as reflected in article 16 UCP.⁵

21. The Working Group was divided on whether the uniform law should impose an obligation on the guarantor to inform the principal of a demand made by the beneficiary. The reasons advanced by those opposing such a legal obligation included the following: notice to the principal, while customarily given as a matter of courtesy, would, if based on a statutory duty, undermine the independence and integrity of the guarantor's undertaking and would be contrary to the expectation of certain and expeditious payment; it would constitute an open invitation to the principal to try to obstruct payment on capricious grounds, in view of the fact that the bulk of demands were not fraudulent or abusive; compliance with any such duty to notify was not easily proved; notification to the principal could readily be made a documentary condition of the guaranty letter; and an appropriate sanction for non-compliance could not easily be found.

22. The proponents of a statutory duty to notify the principal advanced the following reasons: a provision in the uniform law that was not mandatory would not prompt a dramatic change of what apparently was a widespread current practice; it would leave intact the independent assessment and decision of the guarantor whether or not to honour the claim; notice to the principal was a matter of fairness since the principal was the person most likely to know, and to provide information to the guarantor, about any possible fraud or abuse and since it was ultimately the principal whose funds were at stake.

23. Divergent views were expressed on whether notice would have to be given before payment. Under one view, notice was neither useful nor necessary if made after payment. The prevailing view, however, was that the duty of notification should not be linked in terms of time to the duty of examining the claim and deciding about payment. According to that view, payment could be made (within the time allowed for examination of the claim) before notice was given (within the time period provided therefor), and non-compliance with the duty of notification would not affect the validity or effectiveness of payment but might under certain circumstances lead to a claim for damages. It was noted that the question of damages was still to be considered by the Working Group for this and other possible instances of breach of obligations.

24. With a view to providing the principal with knowledge about a claim without imposing the burden of notification on the guarantor, a suggestion was made to require the beneficiary, either on an opting-in or (for bank guarantees only) an opting-out basis, to present to the guarantor with its claim a (certified) statement that either

³ICC document No. 460/470-1/19 Rev. and 460/470-10/1 Rev. of 8 February 1991.

⁴The provisions of draft article 10 URDG are reproduced in paragraphs 15 and 25 of this report.

⁵References to articles of UCP are to the text of the 1983 revision, ICC Publication No. 400, reproduced in document A/CN.9/251.

the original or a copy of the claim had been sent directly to the principal so that the guarantor had documentary proof of the notice before its payment. While attracting some interest, the suggestion was not accepted for the following reasons: it would necessitate a considerable change of current notification practice; it would create unnecessary technical difficulties; the envisaged sanction of prompt dishonour was too rigid; and it created a dichotomy between stand-by letters of credit and bank guarantees that was unwarranted at least in the context of notice to the principal.

Notice of rejection to beneficiary

25. It was noted that draft article 10(b) URDG dealt with the issue of notice of rejection as follows:

"If the Guarantor decides to refuse a claim, he shall immediately give notice thereof to the Beneficiary by teletransmission or, if that is not possible, by other expeditious means. Any documents presented under the Guarantee shall be held at the disposal of the Beneficiary."

26. It was stated that a more extensive rule of notification, coupled with sanctions, was found in the practice of stand-by letters of credit as reflected in article 16 UCP.

27. The Working Group was agreed that the uniform law should contain a provision obliging the guarantor to give notice of rejection to the beneficiary. There was wide support for requiring that the notice indicate why the guarantor had decided to refuse payment. However, it was felt that the requirement of giving reasons should be sufficiently flexible to take into account the variety of payment conditions found in guaranty letters. It was suggested that the requirement should be sufficiently general to relieve the guarantor from specifying particular details, as would be appropriate in the different context of commercial letters of credit; it was pointed out, however, that such a rule would be inappropriate for stand-by letters of credit which sometimes required detailed documentation.

28. Divergent views were expressed on whether the uniform law should contain a rule of preclusion along the lines of article 16(d) and (e) UCP. Under one view, such a rule was inappropriate for guaranty letters since, compared with commercial letters of credit, there tended to be considerably fewer documents and a considerably lesser potential for discrepancies, and the documents did not become "stale" 21 days after the date of the bill of lading (as under article 47(a) UCP). The prevailing view, however, was that the idea of preclusion might be appropriate in the context of guaranty letters but that the precise conditions and consequences needed further study, taking into account the characteristics and practices concerning stand-by letters of credit and independent guarantees.

Further duties of notification

29. The Working Group considered whether the uniform law should deal with further duties of notification that

might form part of the international "rules of traffic", for example, the duty of any financial institution that had received a request for issuing, confirming or advising a guaranty letter to inform the requesting party within a given time about its decision not to comply with that request. The Working Group was agreed that the uniform law should not deal with such duties.

C. Liability and exemption

30. The Working Group considered, on the basis of the discussion set forth in document A/CN.9/WG.II/WP.68, paragraphs 65-72, whether the uniform law should contain provisions on the liability of guarantors and on possible exemptions from liability. It was noted that draft articles 11 to 14 URDG⁶ contained detailed provisions exempting guarantors and instructing parties from liability or responsibility in respect of a great variety of acts or omissions and that draft article 15 URDG limited the effect of these exemptions by imposing liability on guarantors and instructing parties "for their failure to act in good faith and with reasonable care".

Provisions on exemption

31. The Working Group was agreed that the uniform law should not contain any exemption provisions of the kind included in URDG. It was felt that it would not be appropriate to deal with exemption from liability at the statutory level; the issue should be left to the contractual level and settled in uniform rules such as URDG, in general conditions or in individually negotiated agreements. Moreover, an elaborate set of exemption clauses was neither needed nor appropriate in the uniform law, which was certain to contain considerably fewer operational rules or similar provisions on obligations than URDG or UCP.

Rule on liability and its elements

32. Some doubts were expressed concerning the need for including in the uniform law a rule on liability. It was pointed out that questions of liability rarely gave rise to court litigation; that the issue could be left to the general law in a given legal system; that no generally acceptable standard that would also deal with the controversial issue of liability for the conduct of employees could be found; and that the provision of draft article 5 of the uniform law sufficed.⁷ After deliberation, it was agreed, however, that the uniform law should contain a rule of liability along the lines of draft article 15 URDG.

33. As regards the elements of the standard of liability, it was agreed that the concept of "good faith" should be

⁶Draft articles 11 to 14 URDG are set forth in document A/CN.9/WG.II/WP.68, para. 65.

⁷Draft article 5, which the Working Group decided to place between square brackets (A/CN.9/342, para. 41), reads as follows:

"In the interpretation of this Law, regard is to be had to its international [character] [origin] and to the need to promote uniformity in its application and the observance of good faith in international guaranty or credit practice."

retained. As regards the concept of "reasonable care", divergent views were expressed, often depending on whether a mandatory or a non-mandatory rule of liability was envisaged. As regards a mandatory rule from which parties may not derogate by means of exemption clauses, one view was that the standard of reasonable care was appropriate since guarantors were justifiedly expected to exercise professional diligence. As regards a mandatory rule, the prevailing view, however, was that the standard of reasonable care, possibly qualified by a reference to banking practices, was too strict as an unbreakable limit; a mandatory rule of liability should be more restricted, for example, to grossly negligent or reckless conduct.

34. Further suggestions for modifying or supplementing the element of "reasonable care" aimed primarily at an additional liability rule that, according to a widely supported proposal, would not be mandatory and would supplement the draft provision on the standard of care in examining documents that had been discussed at the fourteenth session (see A/CN.9/342, paras. 106-110). The suggestions included references to best banking practices; to good banking practices as generally recognized; to professional diligence; and to banking practices as laid down, for example, in UCP, bankers' manuals and local, national or regional white papers. In response to suggestions referring to banking practices, it was pointed out that the setting of standards could not exclusively and ultimately be left to the persons subjected to the standard; that such banking practices were not everywhere established and often uncertain; and that the reference to the category of persons affected was unnecessary since any standard of care had to be judged in the professional context involved.

Possible extension of liability rule beyond guarantors

35. It was suggested that the future liability rule in the uniform law should be extended beyond guarantors and cover all participants in the guaranty letter transaction, in particular the beneficiary and the principal. It was pointed out that the requirement of good faith was fundamental and should govern the conduct of all parties involved. Moreover, a mandatory liability rule that was limited to guarantors would lead to the wrong conclusion that the uniform law condoned unlimited exemption from liability in respect of the other parties mentioned in the uniform law. A more limited suggestion was that, in view of the fact that the uniform law focused on the guarantor-beneficiary relationship, only the beneficiary should be covered in addition to the guarantor.

36. The prevailing view, however, was to limit the liability rule to guarantors and, possibly, instructing parties. It was felt that an extension of the liability rule beyond those parties would require defining different standards for the respective commercial contexts and addressing the issues of sanctions or remedies; all that would unduly encroach on current national laws that were able to deal with such questions without the help of the uniform law.

III. FRAUD, ABUSE AND SIMILAR CONCEPTS

37. The Working Group considered questions relating to fraud, abuse and similar concepts in the context of guaranty letter transactions. It had before it a note by the Secretariat discussing those concepts and their application in various jurisdictions of common law or civil law tradition (A/CN.9/WG.II/WP.70, paras. 7-75).

38. As suggested in paragraph 9 of that note, the Working Group first considered whether the uniform law should address instances of fraud or abuse that might be relevant otherwise than as an objection to payment. It was agreed that the uniform law should not address such instances of misconduct by persons other than the beneficiary. However, during the subsequent discussion on the fraud exception, a suggestion was made to consider at a later stage the advisability of addressing any possibly fraudulent or abusive conduct of the principal in seeking to prevent payment on capricious grounds.

A. Scope and possible definition of fraud or abuse

39. The Working Group recalled its general agreement at the twelfth session that, while an effort to harmonize the divergent approaches to the problem of fraud would be difficult, there should be greater uniformity in the treatment of the problem and that the formulation of provisions in the uniform law would be a particularly useful contribution (A/CN.9/316, paras. 147-162). The Working Group commenced its harmonization effort with a preliminary exchange of information on currently used concepts and their interpretation in particular jurisdictions.

Exchange of information on currently used concepts

40. As regards the concept of fraud, it was pointed out that its interpretation was often influenced by criminal law notions. The definitions of fraud stated to be applied in particular jurisdictions included the following: causing by illegitimate means a misunderstanding on the part of another person; presenting documents that contain expressly or by implication material representations of fact that the presenter knows to be untrue; disloyal conduct with the intention to do harm or seek an illicit gain or unjust enrichment. It was stated that in other jurisdictions the term "fraud" had a much less strict meaning encompassing situations in which there was no element of intent; with respect to stand-by letters of credit, fraud meant the absence of a colourable basis for drawing on the credit.

41. As regards the concept of abuse, it was pointed out that it was often applied in the same way as in respect of any other right exercised by a person. Such general definitions of abuse stated to be applied in particular jurisdictions included the following: exceeding the limits of the normal exercise of a right by a reasonable person; exercising a right for a purpose other than that for which it was granted. Other definitions of abuse that were geared to the context of guaranty letters included the following:

demand by a beneficiary that had received full satisfaction; demand for payment despite the obvious non-occurrence of any contingency or risk covered expressly or impliedly by the purpose of the guaranty letter.

42. It was noted that the concept of fraud as well as that of abuse were not only defined in different ways as indicated above but also gave rise to considerable disparity and uncertainty in their application to individual cases. It was further noted that both concepts were often used interchangeably and that no clear distinction could be drawn between them.

43. Accordingly, it was suggested that an attempt should be made not to use in the uniform law the terms "fraud" and "abuse". It was further suggested that, with a view to finding the necessary precise demarcation line of the limited area warranting an exception to the independent payment undertaking, it was desirable to determine the parameters of that area by discussing borderline cases of a possibly controversial nature.

Discussion of cases to delimit scope of fraud exception

44. A question was raised whether a guaranty letter could be established at such a level of abstraction that would make it "fraud-proof". The Working Group, noting that no jurisdiction allowing such a type of stand-by letter of credit or guarantee could be identified, was agreed that it should certainly be inadmissible under the uniform law. It was recognized, however, that in certain jurisdictions the application of the fraud exception might to some extent be limited by inserting contractual clauses such as conclusive evidence or confession of judgement clauses.

45. Few examples were given of situations that fell squarely within the fraud exception, for instance, forgery of documents or other criminal offences. A suggestion was made that another situation falling within the scope of the fraud exception would be the invalidity or non-existence of an underlying transaction to be secured by the guaranty letter.

46. The Working Group considered the following case that, based on the controversy it aroused, might be qualified as a borderline case: the beneficiary of a performance guarantee without a reduction clause demands payment of the full amount, while having suffered damages of a considerably lower amount resulting from the principal's failure to complete the last phase of a construction project. Under one view, the demand should be regarded as abusive (in respect of the balance between the damages and the guarantee amount) because the amount claimed was grossly disproportionate to the loss suffered and thus excessive as measured by the guarantee purpose or by the level of satisfaction received by the beneficiary. Under another view, the demand should not be regarded as abusive since the fraud exception was limited to total failure of consideration, i.e., total absence of any plausible basis for the demand. If a link between the amount payable under the guaranty letter and the specific loss suffered within the underlying transaction was desired, that should be made clear in the guaranty letter itself. For

example, the guaranty letter might contain a reduction clause referring to documented progress of works, or separate guaranty letters for the individual phases of the project might be issued.

47. Another case mentioned with a view to exploring the limits of the fraud exception was that of a performance guarantee relating to a contract for the establishment of a telephone system where the malfunctioning of some telephones led to a dispute between the contracting parties that required the engagement of an expert. One comment made on this case was that, irrespective of whether the malfunctioning of some telephones might be regarded as lack of complete performance, the very need of engaging an expert excluded the application of the fraud exception since the requirement of manifest or obvious abuse without the need for further investigation was not met.

48. The Working Group was agreed that the fraud exception should not apply in circumstances where there was an honest dispute between the parties to an underlying transaction about factual or legal questions concerning performance. It was realized, however, that it was not easy to formulate a precise demarcation line between such contractual disputes and those instances that should fall within the scope of the fraud exception.

Possible criteria and approaches for defining scope of fraud exception

49. The Working Group considered the question, raised in the note by the Secretariat (*ibid.*, para. 75, subpara. 1(a)), whether a general definition of the fraud exception should be restricted by a subjective criterion (e.g., evil intent, dishonesty, bad faith) or whether it should, following the prevailing judicial attitude, be based on objective criteria that might be more easily established (e.g., lack of plausible basis, purpose of demand falling outside the covered risk). While some support was expressed for a subjective restriction, it was widely felt that such a restriction would not be appropriate.

50. It was noted, for example, that any subjective requirement such as dishonesty or intent to harm was difficult to establish and that it would often be concluded from objective criteria. It was further pointed out that, while objective criteria appeared more appropriate, subjective elements should nevertheless be added as alternative elements that would become relevant, for example, where the beneficiary presented a true statement with a forged signature. It was realized that the distinction between subjective and objective criteria was unclear and of limited use. The Working Group concluded that any further definition might contain subjective as well as objective criteria.

51. Various suggestions were made concerning a possible definition of the fraud exception in the uniform law. One suggestion was to devise a general definition that might be inspired by any of the definitions referred to during the discussions of the Working Group or in the note by the Secretariat. Another suggestion was that an attempt should be made to describe the scope of the fraud exception by a non-exclusive listing of situations, taking into

account the cases discussed by the Working Group and the instances of possible abuse referred to in the note by the Secretariat. Yet another suggestion was to combine both approaches and to prepare a general definition accompanied by an illustrative list of instances covered. A last suggestion was not to attempt to formulate any kind of definition but merely to provide a guideline that might refer to various concepts, emphasize the character of the guarantor's undertaking and clarify that the exception covered fraud in the transaction and that the facts constituting the basis for the exception had to be established clearly and convincingly without any investigation.

52. The Working Group requested the Secretariat to prepare alternative draft proposals based on the above suggestions, taking into account the tentative deliberations and conclusions of the Working Group.

B. Degree of awareness or standard of proof

53. The Working Group considered the question of the substantive standard of proof or the degree of awareness entitling the guarantor to refuse payment in case of alleged fraud or abuse. It was agreed that the standard had to be strict in view of the exceptional character of that objection to the independent obligation of prompt payment, taking into account the position and reputation of the guarantor and its need for certainty. The view was expressed that, where a guarantor paid in good faith based on conforming documents, it should be entitled to reimbursement even if there was fraud.

54. As regards the possible terms for expressing the strict standard of proof, support was expressed for any of the similar terms mentioned in the note by the Secretariat (*ibid.*, para. 75, subpara. 2(a)), namely "evident", "certain", "obvious to everyone", "manifest", "established by liquid proof". It was pointed out that "manifest" should be understood as "piercing the eyes". Further suggested terms along the same lines included the following: "without any doubt"; "the only reasonable inference"; or "the only realistic inference".

55. As suggested in the note by the Secretariat (*ibid.*, para. 75, subpara. 2(b)), the Working Group considered whether the above standard should be limited to the issue of the guarantor's refusal on its own motion or whether it should apply equally to court orders enjoining payment by the guarantor or restraining the beneficiary from demanding or receiving payment. It was widely felt that, as a rule, the same standard of proof should apply to both situations, i.e., the decision of the guarantor and the decision of the court. It was realized, however, that the difference between the two situations might lead to certain differences in the application of the standard.

56. It was pointed out, for example, that the guarantor had to take a prompt decision within the time allowed for examination of the claim, while a court might have more time or take its decision at a later time, depending on its particular procedures and functioning. Another difference was that the guarantor usually had to base its decision solely on what had been presented by the principal, while

a court might, again depending on its procedures, hear the beneficiary and possibly other parties. Yet another difference was that the guarantor had essentially to rely on documentary proof, while a court might in its summary proceedings admit other means of evidence as well. Moreover, the ordinary standard of proof required in preliminary proceedings was often less than certainty or obviousness by requiring merely the establishment, for example, of a *prima facie* case or of probable success on the merits.

57. In discussing the possible differences between the decision of the guarantor and that of a court, it was realized that the application of the standard of proof in court proceedings could not be viewed in isolation but had to be seen within the procedural framework that tended to differ from one jurisdiction to another. The Working Group therefore decided at that point of its deliberations to take up the subject-matter of injunctions and other court measures, as discussed in the note by the Secretariat (*ibid.*, paras. 90-114). The Working Group later completed its discussion of fraud, abuse and similar concepts (see paragraphs 67 to 77 below).

V. INJUNCTIONS AND OTHER COURT MEASURES

58. The Working Group engaged in an exchange of information on the availability and the particular features of injunctive relief in a given jurisdiction, often supplementing the information provided by the note of the Secretariat. It was noted, for example, that not all jurisdictions appeared to provide procedures for injunctive relief to enforce the fraud exception; in one jurisdiction referred to, a court order enjoining the guarantor from paying was available only if the guarantor or the principal had brought a substantive claim against the beneficiary and the court order aimed at securing that substantive claim.

59. It was further noted that there existed considerable disparity as regards the particular stages and the usual timing of procedures for injunctive relief. For example, in one country temporary restraining orders in *ex parte* proceedings without service of process might be obtained within hours, followed by preliminary proceedings, with stricter procedural requirements, that might last some months, while in another country a preliminary injunction, based on a hearing, could be obtained within a few days. In respect of the different length of the proceedings, it was noted that, while applications for injunctions were reportedly very rarely successful in most jurisdictions, longer proceedings lent themselves to being abused by principals for dilatory purposes.

60. With a view to reducing the risk of such obstruction, some jurisdictions required applicants to place a bond or security deposit. It was pointed out that this device might usefully be introduced in other jurisdictions as well.

61. A less favourable reception was given to another suggested device which was to order the guarantor, where there was uncertainty about the question of fraud, to put the amount of the guaranty letter into escrow or to pay it

into court until the question was finally settled in main proceedings. It was felt that such an order would not accord with the integrity of the guaranty letter and with the restriction of the fraud exception to obvious or manifest cases.

62. The Working Group noted that there existed disparities concerning the specific types of injunctive relief available in various jurisdictions and in respect of the actual use and rate of success of these types. In various jurisdictions, the type of relief most likely to be sought was a stop-payment order against the guarantor. Another type of injunction against the guarantor, available in various jurisdictions, was an order to prevent the guarantor from debiting the account of the principal. The most promising measure in relative terms appeared to be in certain jurisdictions an attachment of the funds that either were still in the hands of the guarantor or formed part of the beneficiary's assets within the jurisdiction concerned. It was pointed out that the least effective measure was to restrain the beneficiary from either demanding or receiving payment, particularly in view of the fact that its place of business was likely to be in a foreign country.

63. Various references were made to particular features of injunctive relief that not only differed from one jurisdiction to another but were also often uncertain or controversial within a given jurisdiction. One such feature was the relationship between preliminary proceedings and main proceedings and any time requirements for initiating any such linked proceedings. A related feature was whether both kinds of proceedings had to be between the same parties. Yet another feature was the possible requirement of a cause of action for the specific type of relief sought and the important question whether the guarantor was not only entitled to refuse payment of a fraudulent call but was under a duty to do so, whether that duty was based on contract or on tort.

64. In the light of the above disparities and uncertainties, it was widely felt that it would be desirable to achieve a greater degree of certainty and uniformity. However, divergent views were expressed as to whether and, if so, what the uniform law could contribute towards that goal. One view was that the uniform law should limit itself to issues of substantive law and not touch upon procedural law matters. The prevailing view, however, was that uniform provisions of substantive law on the fraud exception would be of limited value unless accompanied by harmonized and certain procedural measures and that, therefore, an attempt should be made at furthering that goal without encroaching on the organization of national courts and their traditional procedures.

65. One suggestion was to consider the advisability of a provision that would in general terms deal with the access of all parties to the courts and call for expeditious proceedings, provided that the courts of the given jurisdiction had appropriate rules and procedures. Another suggestion was to make an attempt to lay down guidelines concerning the standard of proof and other features of special relevance in guaranty letter transactions, without thereby dramatically changing the current procedures and functioning of national courts.

66. As regards any jurisdiction that did not currently provide for injunctive relief at all, a hope was expressed for a possible change in the future. It was agreed, however, that it was unrealistic to try to impose such change by the uniform law. Therefore, the alternative draft provisions that the Working Group requested the Secretariat to prepare on the basis of the above suggestions should be formulated in a manner not mandating any such change.

III. FRAUD, ABUSE AND SIMILAR CONCEPTS (*continued*)

C. Fraud exception available to counter-guarantor

67. The Working Group resumed its deliberations on fraud, abuse and similar concepts by considering the question, raised in the note by the Secretariat (*ibid.*, para. 75, subpara. 3), what special considerations applied to the fraud exception available to a counter-guarantor (first bank) in cases involving fraud or abuse by the ultimate beneficiary. The situation envisaged was that of a payment demand by the counter-guarantor's beneficiary (second bank) that had received from the ultimate beneficiary a demand for payment under its indirect guaranty letter. The specific questions raised in the note by the Secretariat were whether any fraud or abuse by the ultimate beneficiary should be relevant where there was no collusion between the ultimate beneficiary and the second bank, and, if so, what the requirements should be for recognizing the ultimate beneficiary's conduct as a basis for the fraud exception available to the counter-guarantor/first bank.

68. In discussing those questions, it was agreed that the guaranty letters issued by the first and the second bank were separate and independent undertakings that often differed as regards their terms and conditions for payment. As indicated in paragraph 66 of the note by the Secretariat, the issue of fraud or abuse as an objection to payment under the counter-guaranty letter would be determined exclusively within the relationship between the two banks, taking into account the purpose of the counter-guaranty letter to indemnify the second bank according to the terms and conditions of that guaranty letter. Accordingly, any fraud or abuse by the ultimate beneficiary could not as such be imputed to the second bank but could become relevant only in the context of a fraudulent or abusive demand by that bank against the first bank.

69. Divergent views were expressed as to the conditions under which a demand by the second bank would be abusive so as to entitle the first bank to refuse payment. One view was that the fraud exception should be limited to the case of collusion between the ultimate beneficiary and the second bank. Another view was that the second bank's demand was abusive if it knew before payment of the fraud by the ultimate beneficiary. Yet another view was that the second bank was not entitled to reimbursement if it had acted negligently, i.e., failed to exercise professional care. A further view was that the second bank was entitled to reimbursement if it had acted in good faith.

Additional requirements suggested were that the misconduct of the ultimate beneficiary constituted an objection to payment under the law applicable to the second bank's undertaking or that it led to a recognized duty of the second bank to refuse payment.

70. In view of the fact that these additional requirements referred to legal issues possibly to be determined under foreign, uncertain laws, concerns were expressed that the question of the fraud exception available to the counter-guarantor might be too complicated to be dealt with appropriately in the uniform law. Another reason advanced against addressing that question was that, for lack of specificity, the situation was appropriately covered by the general provisions on the fraud exception, as discussed earlier by the Working Group. It was stated in reply that the very issues showed a need for provisions covering that special situation.

71. After deliberation, the Working Group decided to reconsider at its next session, on the basis of draft provisions prepared by the Secretariat in the light of the above suggestions, whether the uniform law should contain a special provision on the fraud exception available to the counter-guarantor.

D. Persons against whom the fraud defence may not be invoked

72. The Working Group, responding to a question raised in the note by the Secretariat (*ibid.*, para. 75, subpara. 4), was agreed that there was no need for indicating in the uniform law the kind of persons against whom the fraud defence might not be invoked.

E. Possible provision on "extend or pay" requests

73. The Working Group noted that "extend or pay" requests had been listed in the note by the Secretariat as a possible source of abuse under certain circumstances (*ibid.*, paras. 51-54) and that, apart from that context, consideration by the Working Group was invited on whether the uniform law should contain a provision dealing with such requests, possibly along the lines of draft article 26 URDG, which read as follows:

"If the Beneficiary requests an extension of the validity of the Guarantee as an alternative to a claim for payment submitted in accordance with the terms and conditions of the Guarantee, the Guarantor shall without delay so inform the party which gave the Guarantor his instructions. The Guarantor shall then suspend payment of the claim for such time as is reasonable to permit the Principal and the Beneficiary to reach agreement on the granting of such extension and for the Principal to arrange for such extension to be issued.

"Unless an extension is granted within the time provided by the preceding paragraph, the Guarantor is obliged to pay the Beneficiary's conforming claim

without requiring any further action on the Beneficiary's part. The Guarantor shall incur no liability (for interest or otherwise) should any payment to the Beneficiary be delayed as a result of the above-mentioned procedure.

"Even if the Principal agrees to or requests such extension, it shall not be granted unless the Guarantor and the Instructing Party(ies) also agree thereto."

74. It was noted that "extend or pay" requests were frequently encountered in guarantee practice. It was pointed out that no such practice existed regarding stand-by letters of credit and that an "extend or pay" request in the context of stand-by letters of credit would be regarded as a request to amend. As indicated in the note by the Secretariat (*ibid.*, para. 52), there existed a variety of possible motives for "extend or pay" requests; whether a given request was made in good faith or in bad faith was usually difficult to judge, especially by the guarantor. Notice to the principal was therefore deemed necessary, in addition to the reason that a guarantor wanted the principal's consent to any extension of the validity period of the guaranty letter.

75. While recognizing the potential problems created by "extend or pay" requests, divergent views were expressed as to whether the uniform law should deal with that problem otherwise than as a possible source of abuse. One view was that the problem should not be addressed at the statutory level but should be left to the agreement of the parties, including any general conditions or uniform rules such as URDG. Another view was that the problem was sufficiently vexing and crucial to warrant its treatment in the uniform law; however, it might be dealt with less elaborately than in draft article 26 URDG and might be confined to the following principles: requirement of notice to principal; requirement of principal's consent to extension; principal's consent or request not binding on guarantor; suspension of payment and obligation to pay in case of non-extension only if the payment demand was in conformity with the terms and conditions of the guaranty letter.

76. It was noted that these principles were adopted by draft article 26 URDG. Concerns were expressed, however, in connection with the time of suspension provided for in that draft article and its implications as regards the time allowed for examining the demand and on the expiry date. It was suggested that consideration should be given to replacing the uncertain formula of "reasonable time" by a fixed time period and to clarifying the implications of the suspension in any future provision of the uniform law. The view was expressed that the guarantor (or counter-guarantor) should in no circumstances be required to extend the guaranty letter (or counter-guaranty letter) without having consented to the extension and that the running of the validity period should not be suspended by a request for extension.

77. After deliberation, the Working Group decided to reconsider the matter on the basis of draft provisions by the Secretariat.

IV. OTHER OBJECTIONS TO PAYMENT

78. The Working Group considered whether the uniform law should contain provisions on other objections to payment, as discussed in the note by the Secretariat (*ibid.*, paras. 76-89).

A. Invalidity, voidability or unenforceability of payment obligation

79. The Working Group discussed some cases of invalid, voidable or unenforceable payment obligations. Reference was made, for example, to national or international prohibitions of funds transfers and to the problem of a payment obligation in a non-convertible currency unavailable at the place of payment.

80. While recognizing the importance of such issues and problems, the Working Group was agreed that the uniform law should not contain any special provisions dealing with instances of invalidity, voidability or unenforceability of payment obligations under guaranty letters.

B. Set-off with claims of guarantor

81. Divergent views were expressed as to whether the uniform law should deal with the question of set-off against a demand for payment under a guaranty letter. One view was that the matter should be left to the agreement of the parties within the framework of the applicable national law. It was felt that the uniform law could not appropriately address all the complex issues, including the substantive and procedural requirements of set-off that varied from country to country. Another view was that the uniform law should contain provisions that would help to overcome the existing disparities and uncertainties, while giving full autonomy to the parties and not encroaching on laws governing bankruptcy or insolvency.

82. As regards the possible contents of any future provision in the uniform law, it was widely felt that the guarantor should not be entitled to a set-off with claims assigned to it by the principal. As regards the guarantor's own claims, divergent views were expressed (along the lines of the different views reported in paragraphs 83 to 85 of the note by the Secretariat). One view was to disallow set-off since the guarantor should not be guided by its own interest and the beneficiary justifiably expected actual payment. Another view was to allow set-off since it was not contrary to the independent nature of the undertaking and there was no reason for treating a guaranty letter differently from a bill of exchange. An intermediate view was to allow set-off in certain circumstances.

83. After deliberation, the Working Group decided to reconsider the matter on the basis of draft provisions prepared by the Secretariat in the light of the above views.

VI. CONFLICT OF LAWS AND JURISDICTION

84. The Working Group had before it a note by the Secretariat discussing conflict of laws and jurisdiction as

possible further issues of the uniform law (A/CN.9/WG.II/WP.71).

A. Preliminary discussion on appropriateness of including in the uniform law provisions on conflict of laws and jurisdiction

85. The view was expressed that it would be inappropriate to consider the inclusion of provisions on conflict of laws and jurisdiction in the uniform law that was devoted to substantive law matters. Provisions of that kind would be particularly inappropriate if the uniform law were to be adopted in the form of a convention since such a convention would establish the requirements for its own application. Only a separate convention on the law applicable to international guaranty letters could regulate in sufficient detail the many complicated questions concerning, for example, the modalities of choice-of-law clauses and the clear delimitation of the scope of the applicable law. In view of the complexity and difficulty of the subject-matter, appropriate provisions could be formulated only in a different forum (e.g., another UNCITRAL working group) or by a specialized organization such as the Hague Conference on Private International Law. Yet another reason advanced against the inclusion of provisions on conflict of laws and jurisdiction in the uniform law was that there was no need for such provisions in view of the fact that issues of conflict of laws or jurisdiction rarely gave rise to problems in practice, as evidenced by the dearth of relevant court decisions.

86. It was stated in reply that it was appropriate to consider the possibility of including in the uniform law provisions on conflict of laws and jurisdiction. There existed an inner link between those matters and the previously discussed substantive law issues, including possible court measures. There was also an element of timing involved, in view of the various ongoing unification efforts in the field of guarantees and letters of credit. It was deemed useful at least to discuss the issues raised in the note by the Secretariat with a view towards identifying problems and pondering possible solutions. After that discussion, an informed decision could be taken on whether the uniform law should contain some provisions on conflict of laws and jurisdiction or whether the matter should, for example, be recommended to be taken up by the Hague Conference on Private International Law. A view was expressed that, following the approach adopted by the 1930 Geneva Conventions on Bills of Exchange and Promissory Notes, a separate convention on conflict of laws could be prepared, in addition to the substantive uniform law currently under preparation, and that this task could well be accomplished by UNCITRAL itself, using some form of cooperation with the Hague Conference on Private International Law.

87. After deliberation, the Working Group decided to discuss the issues relating to conflict of laws and jurisdiction, in the expectation that such a discussion, which would in itself be of use, would be of help to the later decision of the Working Group on any future course of action concerning the regulation of those issues.

B. Relationships to be covered by possible conflict-of-laws rules

88. The Working Group considered which relationships should be covered by conflict-of-laws rules if it was later decided that such rules were to be included in the uniform law. The Working Group agreed with the suggestion in the above note by the Secretariat (*ibid.*, para. 10) that the focus should be on the relationship between guarantor and beneficiary, covering the relationship between any kind of guarantor (e.g. indirect guarantor, counter-guarantor, confirming guarantor) and its beneficiary.

89. In response to the question raised in paragraph 11 of the note by the Secretariat, the Working Group was agreed that no other relationship than that between a guarantor and its beneficiary should be covered.

C. Designation of applicable law

90. The Working Group reaffirmed its agreement at the twelfth session (A/CN.9/316, para. 164) that any possible provisions on conflict of laws should be composed of two elements: recognition of party autonomy to choose the applicable law, and determination of the applicable law failing agreement by the parties.

1. Freedom of parties to choose applicable law

91. The Working Group considered whether the parties' freedom of choice should be unlimited or whether the law chosen by the parties should have a certain connection with the guaranty letter transaction. While there was some support for requiring a certain connection or precluding an unreasonable choice, it was widely felt that the freedom of the parties should be unlimited since any kind of limitation would create undesirable uncertainty and because there was a practical need to allow parties to choose a law that bore no connection with the transaction, for example, because it was perceived as neutral or particularly refined.

92. As suggested in paragraphs 18 to 21 of the note by the Secretariat, the Working Group considered the form and modalities of the choice by the parties. It was noted that in respect of those issues account should be taken of the characteristics of the guaranty letter, including its independent and formalistic nature and the fact that, at least from a practical point of view, the choice of the law was not always effected by a genuine agreement of both parties.

93. While a suggestion was made to recognize only an express choice, it was widely felt that that requirement would be too strict. Various suggestions were made as to which non-express modalities of choice should be allowed. One suggestion was to use the formula of article 3(1) of the Convention on the Law Applicable to Contractual Obligations (Rome, 1980): "The choice must be expressed or demonstrated by the terms of the contract or the circumstances of the case." Other suggestions that were made with reference to the above characteristics of the guaranty letter included the following: to use the

formula of the 1980 Rome Convention but without the words "or the circumstances of the case"; to adopt the formula of article 2 of the 1955 Hague Convention on the Law Applicable to International Sales of Goods and require that the choice be by "an express clause or result without doubt from the terms of the contract"; to provide that the choice of law "may be implied from the terms of the guaranty letter".

94. In response to the question raised in paragraph 21 of the note by the Secretariat, the Working Group was agreed that there was obviously no need to include in the uniform law a statement to the effect that any choice-of-law clause found in another relationship had no bearing on the issue of the law applicable to the guarantor-beneficiary relationship.

2. Determination of applicable law failing choice by the parties

95. As regards the possible content of a provision determining the applicable law in the absence of a choice by the parties, it was noted that the solution prevailing in most jurisdictions was the law of the guarantor's country. The Working Group adopted that solution as the basic rule, with a qualification for those cases where the guarantor (or counter-guarantor) had more than one place of business, as suggested in paragraph 27 of the note by the Secretariat.

96. On the basis of the discussion in paragraphs 28 to 35 of that note, the Working Group considered whether the above basic rule might be refined for those cases where, in addition to one guarantor, another bank was involved either as another guarantor or as an advising bank or paying agent. The primary question considered was whether in such cases the obligations of the various banks involved should, in the absence of choice-of-law clauses, be governed by a single law.

97. The first situation considered was that of an indirect guaranty letter that was counter-guaranteed by the instructing party. A view was expressed that it might be desirable for the sake of consistency and certainty to apply to both guaranty letters a single law which, according to one suggestion, should be that of the counter-guarantor as the last link in the guarantee chain and, according to another suggestion, that of the other guarantor as the one from whom the ultimate beneficiary would demand payment. However, it was widely felt that it was neither practical nor justified to accord statutory priority to one of two possibly differing laws and impose the law of one guarantor on another one. Such an imposition would undermine the independent character of the two, or possibly more, separate undertakings, while parties, if they wished a single law to govern, could achieve that result by appropriate choice-of-law clauses.

98. The next situation considered was that of a guaranty letter that was confirmed by a bank in another country. It was noted that in that situation, found less frequently in respect of bank guarantees than stand-by letters of credit, the beneficiary could demand payment from the

confirming or the issuing guarantor, unlike in the counter-guarantee situation where the ultimate beneficiary could not demand payment from the counter-guarantor. While recognizing that special feature of the case of confirmation, the Working Group was agreed that the uniform law should not impose a single law on both the issuing and the confirming guarantor.

99. The next situation considered was that of the involvement of an advising bank. It was noted that the types of involvement differed considerably in practice, ranging from the mere function of notification or of forwarding documents to greater responsibilities such as examining the claim and effecting payment on behalf of the guarantor. The Working Group was agreed that, even in cases of such greater responsibilities, the above basic rule pointing to the guarantor's (or counter-guarantor's) place of business should be retained. It was stated, in that connection, that "the place of payment" was not an appropriate connecting factor since it constituted an uncertain legal concept and might create practical difficulties, particularly if the place of payment was not clearly stated in the guaranty letter. As regards the function of examining claims, a suggestion was made to explore possible methods of achieving the application of local standards of examination.

100. Finally, the Working Group considered whether a single law should govern the whole socio-economic network of contracts related to guarantee transactions, including not only the various guarantor-beneficiary relationships but also the relationships between the principal and the issuing guarantor and between the principal and the beneficiary. The Working Group was agreed not to impose a single law on such a global network of contractual relationships.

101. A suggestion was made, in that connection, that any future conflict-of-laws rule in the uniform law should introduce a degree of flexibility as done by article 4(5) of the 1980 Rome Convention on the Law Applicable to Contractual Obligations according to which the presumption in favour of the place of business of the party that was to effect the characteristic performance would be disregarded if it appeared from the circumstances as a whole that the contract was more closely connected with another country. It was stated in reply that such an escape clause, apart from forming part of an elaborate scheme of presumption, would not be appropriate for guaranty letters in view of their special characteristics, namely their independent and formal nature as well as their mode of establishment. It was realized that it might be difficult for a State that adhered to the 1980 Rome Convention to accept a different conflict-of-laws rule and that that difficulty might shape its position on the general question of whether the uniform law should include conflict-of-laws provisions at all. It was also realized that the 1980 Rome Convention dealt generally with contractual obligations and, as indicated by the fact that it excluded bills of exchange, might not appropriately address the specifics of guaranty letters; that there existed within that Convention a mechanism for later changes; and, above all, that the universal composition of the Working Group necessitated due regard to the interests of States not adhering to that

Convention. A concern was expressed that, if the discussion of a particular region's laws were to continue, other countries might wish to discuss other regional bilateral or multilateral conventions or limitations.

3. *Scope of applicable law*

102. The Working Group took note of the discussion on the scope of the applicable law set forth in paragraphs 36 to 41 of the note by the Secretariat. It was understood that the issues mentioned therein were meant to be illustrative of the kind of questions governed by the law determined according to the possible conflict-of-laws rule in the uniform law and were primarily designed to assist the Working Group in finding an appropriate formula for indicating the scope of the applicable law.

103. As regards such a possible future formula, the Working Group favoured the approach suggested in paragraph 43 of the note by the Secretariat, i.e., to refer to "the rights and obligations arising out of a guaranty letter", with possible exceptions for issues falling outside the scope of the applicable law and with possible clarifications concerning the inclusion of issues that not everyone might expect to fall within the scope of the applicable law. Various drafting suggestions were made, including the following: to mention in addition to "rights and obligations" also "defences" and, taking into account the counter-guarantee and agency relationships between the counter-guarantor and the guarantor, to widen the notion of "arising out of the guaranty letter" by wording such as "or relating to".

D. *Jurisdiction*

104. The Working Group recalled its preliminary discussion on the appropriateness of including in the uniform law provisions on conflict of laws and jurisdiction (see paragraphs 85-87 above). The following additional points were made in respect of possible rules on jurisdiction.

105. The view was expressed that the subject-matter of court jurisdiction was particularly complex and complicated and that only a very detailed regulation could do justice to that complexity. There existed already satisfactory and detailed regulations of that subject-matter in multilateral treaties (e.g., the 1968 Brussels and 1988 Lugano Conventions on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters). Moreover, the question of court jurisdiction had hitherto not been dealt with in conventions devoted to other subject matters. It was also observed that the Hague Conference on Private International Law, despite its specialization in that subject-matter, had essentially limited its unification efforts to an indirect treatment such as recognition of court judgements.

106. It was stated in reply that the subject-matter of jurisdiction was of considerable practical importance and that its treatment in the special context of guaranty letters would be useful, for example, as regards the validation of an arbitration or choice-of-forum clause in the guaranty

letter which, as a rule, was not signed by the beneficiary. As regards the existence of multilateral treaties on the subject, it was stated that that should not preclude the inclusion of provisions on jurisdiction in the uniform law, taking into account the interests of those States not adhering to those treaties. The interests of the States adhering to those treaties could well be accommodated by reservation clauses if the uniform law were to be adopted in the form of a convention. It was further pointed out that there existed a number of conventions, especially in the area of transport, that contained provisions on jurisdiction and arbitration.

107. Without taking a decision on whether provisions on jurisdiction should be included in the uniform law, the Working Group exchanged views on the issues discussed in the note by the Secretariat. The Working Group was agreed that, as discussed in paragraphs 46 to 50 of that note, arbitration or forum clauses should be allowed. One suggestion was to clarify that there was no need to effect such choice by a clause contained in the original guaranty letter and that it could be effected at any time by a separate agreement. Another suggestion was to allow parties to empower arbitrators to decide their dispute according to rules of law such as an internationally agreed uniform law or international customs or uniform rules.

108. As regards the determination of jurisdiction failing a choice by the parties, as discussed in paragraphs 51 to 55 of the note by the Secretariat, strong reservations were expressed against providing for exclusive court

jurisdiction. It was stated in reply that exclusive jurisdiction of the courts in the guarantor's country would be advantageous in that the courts would be able to apply their own, familiar law, according to the above basic rule on the applicable law (see paragraph 95), and that the enforcement of any decision against the guarantor as the most likely defendant was ensured.

109. Finally, the Working Group considered the suggestion, set forth in paragraphs 56 to 58 of the note by the Secretariat, that any provision on jurisdiction might be expanded so as to cover the principal as the most likely party to initiate proceedings. The view was expressed that such expansion would be inappropriate since neither the substantive law provisions nor any possible conflict-of-laws provisions of the uniform law dealt with the principal-guarantor relationship. Another view was that, since certain issues relating to the principal and possibly injunctions brought by the principal might be addressed by the future uniform law, consideration might be given to ensuring in some way that all principals, including foreign ones, had access to the court that would have jurisdiction under the uniform law.

110. The Working Group decided to reconsider the appropriateness of including provisions on jurisdiction in the uniform law. It requested the Secretariat, for that purpose, to prepare tentative draft provisions in the light of the above deliberations and to consult with the Hague Conference on Private International Law on possible methods of cooperation in that field.

D. Working papers submitted to the Working Group on International Contract Practices at its fifteenth session

1. Independent guarantees and stand-by letters of credit: discussion of further issues of a uniform law: fraud and other objections to payment, injunctions and other court measures: note by the Secretariat (A/CN.9/WG.II/WP.70) [Original: English]

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INTRODUCTION

1. The present note on fraud and other objections to payment, injunctions and other court measures is the third in a series of notes discussing possible issues of a uniform law on independent guarantees and stand-by letters of credit. A fourth note that will also be presented to the Working Group at its fifteenth session discusses conflict of laws and jurisdiction (A/CN.9/WG.II/WP.71). The issues discussed in the first note, i.e. substantive scope of uniform law, party autonomy and its limits, and rules of interpretation (A/CN.9/WG.II/WP.65), were considered by the Working Group at its thirteenth session (A/CN.9/330). The issues discussed in the second note, i.e. amendment, transfer, expiry, and obligations of guarantor (A/CN.9/WG.II/WP.68), were considered by the Working Group at its fourteenth session (A/CN.9/342).

2. A preliminary discussion of the fraud exception, other objections and supportive court measures was presented in a report of the Secretary-General (A/CN.9/301, paras. 84-90). One of the conclusions of that report was that the vexing problem of fraudulent or abusive calls and of appropriate court measures, which could not effectively be dealt with by contractual rules, would probably be the most important topic for a uniform law (A/CN.9/301, para. 98). The Commission, when considering that report at its twenty-first session, was aware of the difficulties inherent in a unification effort relating to fundamental concepts of law, such as fraud or similar grounds for objections, and touching upon procedural matters; nevertheless, it was felt that, in view of the desirability of legal uniformity and certainty, a serious effort should be made (A/43/17, para. 24).

3. During the consideration of that topic at the twelfth session of the Working Group (A/CN.9/316, paras. 147-

162), it was pointed out that the effect of fraud on guarantees and letters of credit was a complex question and there was disparity in the concepts and rules applied at the national level. While an effort to harmonize the divergent approaches to the problem of fraud would be difficult, there was nevertheless general agreement that there should be greater uniformity in the treatment of that problem and that the formulation of provisions in the uniform law would be a particularly useful contribution. The Working Group agreed that additional study was required on the various aspects of the fraud exception and, in particular, its relationship to the concept of *abus de droit*. The same was true in respect of other possible objections to payment (e.g., impossibility, illegality, violation of public policy, set-off) as well as any judicial measures to block payment.

4. The present note is designed to assist the Working Group in its deliberations and decisions on the scope and content of possible provisions in the uniform law dealing with those problems. Its first part is devoted to fraud, abuse and similar concepts (I). It presents an overview of the basis and scope of these concepts as used and understood in various legal systems. It also takes a closer look at the actual application of these concepts, in particular the concept of "abuse of right" in civil law jurisdictions, to typical fact situations.

5. The second part of this note discusses other possible objections to payment that might be dealt with in the uniform law (II). A distinction is drawn between the invalidity of the guaranty letter and various instances of the guarantor's inability to perform (e.g., insolvency or foreign exchange restrictions). A brief discussion is presented of the possible impact of public policy on the performance or enforceability of the payment obligation, followed by a discussion of the admissibility of a set-off against the payment claim.

6. The third part of the note discusses injunctions and other court measures that might be used, in particular, for blocking payment (III). While closely linked to the discussion of fraud and other objections to payment, the discussion of court measures is kept separate since it pertains to procedural law where different considerations apply to questions of desirability and feasibility. A brief overview is presented of the various types of judicial measures in different jurisdictions, drawing a distinction between, on the one hand, measures enjoining payment by the guarantor or restraining the beneficiary from calling and, on the other hand, arrest or similar measures relating to the claim or funds. Some suggestions are offered on the possible content and scope of provisions for the uniform law that might contribute to legal certainty and uniformity of available court measures and their procedural requirements.

I. FRAUD, ABUSE AND SIMILAR CONCEPTS

7. As provided in draft article 2 of the uniform law (A/CN.9/342, para. 17), the guarantor's undertaking is to pay "in conformity with the terms of the undertaking". Upon receipt of a demand for payment, the guarantor would thus examine its conformity with the terms of the guaranty letter, as discussed by the Working Group at its fourteenth session under the heading "Obligations of guarantor" (A/CN.9/342, paras. 103-110). In case of conformity the guarantor is obliged to pay, unless there is an exceptional ground recognized as basis for refusing payment. The following discussion deals with the so-called "fraud exception" that might cover fraudulent, abusive, arbitrary or unfair calls (other possible objections to payment despite conformity of the demand will be dealt with below, paragraphs 76-89).

8. It may be noted, however, that instances of fraud or abuse of right are not limited to the presentation of a demand by the beneficiary, but may occasionally be found in the conduct of a bank relating to its obligations. For example, the Federal Court of Switzerland regarded the following conduct of a bank as an attempt to exploit a purely formal position, contrary to the rules of good faith, and thus as an abuse of right: The bank had refused payment under a letter of credit by insisting on the production of a signed delivery receipt (as required under the letter of credit) despite the fact that the complete and regular delivery of the goods had been admitted.¹

9. In this connection, the Working Group might wish to consider whether the uniform law should address instances of fraud or abuse that may be relevant otherwise than as an objection to payment. As agreed at the twelfth session, it is not necessarily advisable to limit application of the fraud provisions to misconduct by the beneficiary, particularly in view of the possibility of misconduct by principals as well as guarantors or issuers of letters of credit (A/CN.9/316, para. 151).

A. The fraud exception in selected common law jurisdictions

10. Turning now to the fraud exception, it seems useful to start with an overview of its basis and scope in different legal systems. While necessarily selective and not authoritative in any sense, the overview attempts to give some idea of the legal source or foundation of the fraud exception in different jurisdictions, of the similarity or differences of certain concepts or labels, and, in particular, of the judicial attitude towards the following main questions that should be addressed by the uniform law: (1) what kind of misconduct constitutes fraud; (2) is the innocent beneficiary or any other person protected against the fraud defence; (3) what is the standard of fraud entitling the guarantor to refuse payment, and does the same standard apply to court orders enjoining payment; (4) do any special considerations apply to the undertaking of a counter-guarantor.

1. United States of America

11. The above questions and other important aspects of the fraud exception have extensively been dealt with in particular by courts in the United States of America. Already 50 years ago, a judge of the Supreme Court of New York reasoned in a letter-of-credit case where the seller had shipped worthless rubbish that, where the facts of the underlying transaction indicate that the seller's failure reaches beyond a mere breach of warranty to the level of a complete failure to perform, "the principle of the independence of the bank's obligation under the letter of credit could not be extended to protect the unscrupulous seller".² The *Szteijn* decision thus recognized in the case of intentional and serious misconduct of the beneficiary an exception to the independence of the undertaking and allowed the Court to look behind facially conforming documents.

12. The decision has been relied upon by other courts in the United States, and referred to by courts in other common law countries,³ and, above all, formed the basis of the legislative treatment of the fraud exception in article 5 of the Uniform Commercial Code (UCC). Section 5-114 (1), (2) reads:

"(1) An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honor of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specified documents must be satisfactory to it.

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the

¹*Société de Banque Suisse (SBS) v. Société Générale Alsace de Banque (Sogénal)*, 11 January 1989 (Ro 115 II 67), reported by Pelichet, *Garanties bancaires et conflits de lois*, in: *Revue de droit des affaires internationales* 1990, 352-353.

²*Szteijn v. Henry Schroder Banking Corp.*, 31 N.Y.S. 2d 631, 634 (1941).

³See cases referred to in notes 28, 33 and 35.

warranties made on negotiation or transfer of a document of title (Section 7-507) or of a security (Section 8-306) or is forged or fraudulent or there is fraud in the transaction

"(a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a security (Section 8-302); and

"(b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor."

13. Section 5-114 UCC deserves special attention since it probably presents the only extensive treatment of the fraud exception in a statute anywhere. It has been applied and interpreted by many US courts, particularly in proceedings for injunctive relief sought by the principal (applicant for the credit) but also in proceedings between the beneficiary and the issuer or between the principal and the beneficiary.

14. As reported by the Task Force on the Study of Article 5 UCC, Section 5-114(2) "has been uniformly construed as providing defenses to the honor of a letter of credit which may be asserted by the issuer or, where the issuer proposes not to assert them, grounds by which the customer may enjoin payment. Most courts have construed Section 5-114(2) to permit the introduction of extrinsic evidence to establish forged or fraudulent documents or fraud in the transaction and have construed fraud in the transaction to mean fraud in the sale or other transaction underlying the credit."⁴ The fact that several courts have discussed the defences of fraudulent documents and of fraud in the transaction in tandem shows the similarity or proximity of these defences where non-genuine documents were presented; in fact, the drafting history suggests that the defence of fraud in the transaction aims at "clean credits", i.e., credits payable without presentation of documents.⁵

15. The courts have given divergent answers as to what precisely constitutes fraud, in particular, fraud in the transaction. Some have required "a clear intent to defraud"⁶ or otherwise referred to "egregious" or "intentional fraud";⁷ others have applied more flexible standards and, for example, regarded as fraud the seller's breach of warranty⁸

or its breach of an implied covenant of good faith and fair dealing *vis-à-vis* the customer,⁹ or used the wide concept of constructive fraud as used in securities' law¹⁰, or not even mentioned fraud, leaving unclear whether the decision was based on lack of compliance or fraudulent act.¹¹

16. The difficulty of determining whether wrongful misconduct is so serious as to justify interruption of the payment of the credit is "in part due to the somewhat slippery character of fraud in US jurisprudence".¹² This finding of the Task Force lies at the heart of its suggested approach "to focus on the notion that the purpose of the underlying transaction must be rendered virtually without value" and, for stand-by letters of credit, that "the drawing has occurred with no colorable basis whatsoever".¹³ This suggestion is inspired by a Pennsylvania decision¹⁴ (followed by many others), according to which the defence of fraud in the transaction is available if "the wrongdoing of the beneficiary has so vitiated the entire transaction that the legitimate purpose of the independence of the issuer's obligation would no longer be served" or, in shorter terms, if "there is no plausible or colorable basis" (for the declaration of default) or, even shorter, if "the beneficiary has no bona fide claim to payment".¹⁵

17. As may be seen from the text of Section 5-114(2)(a), there exists a protected class of specified persons against whom letter-of-credit fraud may not be asserted either in offence or defence. However, the question of who should be immune from the fraud defence embraces also the difficult issue of fraud committed by a third party even where the beneficiary is not part of the protected class. As reported by the Task Force, a number of cases have held that fraud committed by someone other than the beneficiary may qualify under the Section 5-114(2) defence.¹⁶ Such cases include presentation by the beneficiary of documents fraudulently altered by another, fraudulent presentation of pre-signed documents by the beneficiary's assignee of proceeds, fraudulent draw on a foreign bank guaranty inducing draw on a related US bank letter of credit, and fraudulent procurement from investors of letters of credit in favour of a lender to support loans to a limited partnership.

18. It may be noted that the Task Force regards the avoidance of fraud provisions in Section 5-114 as too narrow in some respects and too broad in others; it recommends as a better approach to ask "what type of person would be induced to act under the credit (not who is a 'holder'), who detrimentally rely on its independence and who would be truly injured by a dishonor intended to

⁴An Examination of U.C.C. Article 5 (Letters of Credit), A Report of the Task Force on the Study of U.C.C. Article 5 (Chairman: J.E. Byrne) p. 81.

⁵*Idem*, p. 82.

⁶E.g. *West Virginia Housing Development Fund v. Sroka*, 415 F. Supp. 1107 (W.D.Pa. 1976).

⁷E.g. *United States v. Mercantile National Bank of Dallas*, 795 F. 2d 492 (5th Cir. 1986).

⁸E.g. *NMC Enterprises, Inc. v. CBS, Inc.*, 14 UCC Rep. Serv. 1427 (N.Y.S.C. 1974).

⁹E.g. *Trans Meridian Trading Inc. v. Empresa Nacional de Comercialización de Insumos*, 829 F. 2d 949 (9th Cir. 1987).

¹⁰E.g. *Dynamics Corp. v. Citizens & Southern National Savings Bank* 356 F. Supp. 991 (N.D.Ga. 1973).

¹¹E.g. *Utica Mutual Insurance Co. v. Walker*, 725 S.W. 2d 24 (Ky.Ct.App. 1987).

¹²Task Force Report (note 4) p. 73.

¹³*Ibid.*, p. 73-74.

¹⁴*Intraworld Industries, Inc. v. Girard Trust Bank*, 336 A. 2d 316, 324 (1975).

¹⁵As to a similar understanding of the concept of abuse in civil law jurisdictions, see paragraph 35 below.

¹⁶Task Force Report (note 4) p. 79.

prevent consummation of fraud or forgery (not who 'gave value'), and who was innocent and not too closely connected with the fraudster when induced to act in reliance on the credit (not whether such reliance took the form of payment or purchase before receiving notice of fraud/forgery)".¹⁷

19. Divergent court decisions have been rendered on the question whether the standard of fraud, including the burden of proof, is the same in the different relationships and procedural settings. For example, several decisions recognize that the same standard applies to a defence raised by the issuer/confirmer in an action by the beneficiary for wrongful dishonour as in an action for injunctive relief brought by the applicant,¹⁸ and that the burden of proof rests with the party asserting fraud.¹⁹ Others, however, appear to place on the beneficiary the burden of disproving fraud;²⁰ this allocation of the burden of proof has been criticized by the Task Force.²¹ As regards the comparison with the principal-beneficiary relationship, some courts have held that the same standard of fraud applies irrespective of whether the action is to enjoin the issuer/confirmer from paying or whether the action is to restrain the beneficiary from presenting documents;²² others, however, have treated an action by the applicant solely against the beneficiary as a contract dispute between these two parties and ignored its letter of credit implications.²³ The Task Force has disagreed with this position.²⁴

20. In conclusion, it should be noted that the issue of fraud is mostly dealt with in the context of applications for temporary restraining orders or preliminary injunctions, since it is reportedly unusual for an issuer or confirmer to dishonour a draft or demand on the grounds of fraud (so-called "elective dishonour"). In that procedural context the substantive aspects of the fraud exception constitute, under the heading "probable success on the merits", only one amongst various factors to be weighed (e.g., irreparable injury, balance of convenience, public interest). As reported by the Task Force, courts tend to concentrate more on irreparable injury than on the showing of fraud, in part because many jurisdictions provide for the issuance of a preliminary injunction on a showing of less than 50-50 probability of success on the merits.²⁵ The procedural requirements of restraining orders, preliminary injunctions and other court measures will be discussed below (paragraphs 90-114).

2. England (Canada and Singapore)

21. English courts have recognized the fraud exception but construed it in a more narrow and rigid manner than courts in other jurisdictions. A first illustration of that judicial attitude is the following statement in a case concerning an injunction against payment under a performance guarantee: "It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce . . . Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration."²⁶ It is noteworthy that the judge declared that the plaintiffs had taken the risk of the unconditional wording of the guarantees and at the same time relied on two commercial letter of credit decisions²⁷ as being equally applicable to confirmed performance guarantees.

22. In a similar vein, it was held in another injunction case concerning a performance guarantee that the relevant considerations were those applicable to letters of credit and that the only exception to the irrevocable and independent nature of the guarantee was when clear or obvious fraud on the part of the beneficiary had been established to the knowledge of the bank. In denying relief to the principal who had repudiated the contract because of the beneficiary's failure to open an effective letter of credit, it was remarked: "The bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances where there is no right to payment . . . So long as the customers make an honest demand, the banks are bound to pay; and the banks will rarely, if ever, be in a position to know whether the demand is honest or not. At any rate, they will not be able to prove it to be dishonest. So they will have to pay."²⁸

23. This decision, criticized by one commentator as too rigid in view of the fact that the beneficiary had evidently not even attempted to perform the contract secured by the performance guarantee,²⁹ has been relied upon in other cases.³⁰ Yet, in one such case a somewhat less rigid approach to the standard of fraud and the evidence required for an injunction may be gathered from the following remarks: "While accepting that letters of credit and performance bonds are part of the essential machinery of international commerce (and to delay payment under such documents strikes not only at the proper working of international commerce but also at the reputation and standing of the international banking community), the strength of

¹⁷*Idem*, pp. 80-81.

¹⁸*E.g. Offshore Trading v. Citizens National Bank*, 650 F. Supp. 1487 (D. Kan. 1987).

¹⁹*E.g. Airline Reporting Corp. v. First National Bank of Holly Hill*, 832 F. 2d 823 (4th Cir. 1987).

²⁰*E.g. Arabian Fiberglass Insulation Co. v. Continental Illinois National Bank & Trust Co.*, No. 85C 1268 (N.D. Ill., 19 Dec. 1986).

²¹Task Force Report (note 4) p. 77.

²²*E.g. Jupiter Orrington Corp. v. Zweifel*, 469 N.E. 2d 590 (1984).

²³*E.g. Steinmeyer v. Warner Consolidated Corp.*, 116 Cal. Rptr. 57 (1974).

²⁴Task Force Report (note 4) p. 75.

²⁵*Idem*, p. 69.

²⁶*Harbottle v. National Westminster Bank* (per Kerr J.), Q.B., [1977] 2 All E.R. 862, 870.

²⁷*Hamzeh Malas & Sons v. British Imex Industries Ltd.*, Q.B., [1958] 1 Q.B. 127; *Discount Records Ltd. v. Barclays Bank Ltd.*, Q.B., [1975] 1 W.L.R. 315.

²⁸*Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.*, C.A., [1978] 1 Lloyd's Rep. 166, 171 (per Lord Denning MR and Browne LJ).

²⁹*Schmitthoff, Bank's liability under unconditional performance bond*, *Journal of Business Law* 1977, 353.

³⁰*E.g. Boliventer Oil v. Chase Manhattan Bank, C.A.*, [1984] 1 W.L.R. 392.

this proposition can be over-emphasized . . . [I]t cannot be in the interests of international commerce or of the banking community as a whole that this important machinery that is provided for traders should be misused for the purposes of fraud . . . [W]e would find it an unsatisfactory position if, having established an important exception to what had previously been thought an absolute rule, the Courts in practice were to adopt so restrictive an approach to the evidence required as to prevent themselves from intervening. Were this to be the case, impressive and high-sounding phrases such as 'fraud unravels all' would become meaningless."³¹

24. The fraud exception was further refined in a case where a bank had refused payment after discovering that, unknown to the beneficiary, shipping agents had pre-dated by one day a bill of lading so as to give it the appearance that the goods had been loaded within the shipping period set forth in the letter of credit. The Court of Appeal held that the bank was entitled to refuse payment, stating, *inter alia*, "whether or not a forged document is a nullity, it is not a genuine or valid document entitling the presenter of it to be paid and if the banker to which it is presented under a letter of credit knows it to be forged he must not pay . . . If a document false in the sense that it is forged by a person other than the beneficiary can entitle a bank to refuse payment, I see no reason why a document in any way false to the knowledge of a person other than the beneficiary should not have the same effect . . . There was fraud in the transaction."³²

25. However, the decision was reversed by the House of Lords on the grounds that the case did not fall within the fraud exception, defined as follows: "the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue. Although there does not appear among the English authorities any case in which this exception has been applied, it is well established in the American cases . . . The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim *ex turpi causa non oritur actio* or, if plain English is to be preferred, 'fraud unravels all'. The courts will not allow their process to be used by a dishonest person to carry out a fraud."³³

26. The decision emphasized that the fraudulent bill of lading was not a nullity or worthless to the bank as security for its advances to the buyer, but was a valid transferable receipt for the goods giving the holder a right to claim them at their destination. In fact, it expressly left "open the question of the rights of an innocent seller/beneficiary against the confirming bank when a document presented by him is a nullity because unknown to him it was forged by some third party".³⁴

27. In a similar case concerning an allegedly forged and discrepant inspection certificate, the Supreme Court of Canada agreed with the views expressed by the House of Lords that the fraud exception should be confined to fraud by the beneficiary of the credit and should not extend to fraud by a third party of which the beneficiary is innocent and that the fraud exception should not be opposable to the holder in due course of a draft under a letter of credit. Subject to these limits, the fraud exception is not to be confined to cases of fraud in the tendered documents but includes fraud in the underlying transaction of such character as to make a demand for payment under the credit a fraudulent one. However, to be successful in a claim against the issuer of a letter of credit for improper payment it must be shown that the fraud was sufficiently established to the knowledge of the issuer before payment was made to make the fraud clear or obvious to the issuer.³⁵ As a commentator concluded, the law in Canada is now in accord with that of England on the issue as to the fraud exception, except for the degree necessary to establish fraud in an interlocutory application to restrain an issuer of a letter of credit from paying thereunder. In Canada the degree of proof is "a strong *prima facie* case", while England requires fraud to be "very clearly established".³⁶

28. Finally, it may be noted that, encouraged by the judicial statements set forth in paragraphs 23 and 24, two commentators suggested that "it may be timely for English and Singapore courts to reassess their approach" which had generally been less flexible than that of courts in the United States.³⁷ For example, "an injunction restraining the bank from meeting the seller's demand should be granted whenever fraud is alleged and supported by suitable *prima facie* evidence. Naturally, the granting of the remedy should be subject to obtaining security for costs from the buyer and, in addition, it may be advisable to propose that the amount of the credit—the subject of the dispute—be ordered to be paid into court. The bank could not be alleged to have failed to perform its bargain once it has complied with such an order."³⁸

B. Abuse and fraud in selected civil law jurisdictions

29. The following overview of the law in countries of civil law tradition focuses on jurisdictions with extensive case law (i.e., France, Italy, Germany, Belgium, Netherlands, Switzerland and Austria). While there is no

³¹*The Bank of Nova Scotia v. Angelica-Whitewear Ltd.*, 5 March 1987 (per Le Dain J.), reported in *International Banking Law* (June 1987), p. 10, summarized by Zacks, 'United City Merchants': The Canadian viewpoint, *idem* p. 7 (additional alleged discrepancies related to bills of lading).

³²Zacks (note 35) p. 8 (referring to the English decision set forth above, para. 22).

³³Ho Peng Kee, *The Fraud Rule in Letters of Credit Transactions*, in: *Current Problems of International Trade Financing* (2nd ed. by Ho/Chan, Singapore 1990) p. 208; similarly Ellinger, *Documentary Credits and Fraudulent Documents*, *ibid.*, p. 169 ("It may be that the last word in the development of the doctrine in the UK remains to be said . . . it is believed that the ambit of the fraud rule requires re-examination").

³⁴Ellinger, *ibid.*, p. 208.

³¹*United Trading Corp. v. Allied Arab Bank Ltd.*, C.A., [1985] 2 Lloyd's Rep. 554, 561 (per Ackner L.J.).

³²*United City Merchants (Investments) Ltd. v. Royal Bank of Canada*, C.A., [1981] 1 Lloyd's Rep. 604, 623 (per Stephenson J.).

³³*UCM (Investments) v. Royal Bank of Canada*, [1982] 2 All E.R. 720, 725 (per Lord Diplock).

³⁴*Idem*, p. 728.

uniformity in the use of concepts and their application to particular cases, all jurisdictions recognize the fraud exception as an objection to payment, usually to be determined by reference to the underlying transaction and limited by stringent requirements of evidence.

1. Various concepts or labels

30. As regards the concepts or bases of the fraud exception, a variety of terms have been used by the courts, often more than one in a single jurisdiction and sometimes even in a single decision. For example, German, Swiss and Austrian courts predominantly refer to "manifest abuse",³⁹ Dutch courts often use the formula "evidently arbitrary or deceitful",⁴⁰ Italian courts may refer to fraud (*dolo, frode*), bad faith (*mala fede*) or abuse (*abuso*),⁴¹ and French courts employ the terms "manifest fraud" (*fraude manifeste*) and "manifest abuse" (*abus manifeste*).⁴²

31. Where courts indicate the foundation of the fraud exception, they refer to traditional maxims such as *fraus omnia corrumpit* or *exceptio doli* or to general principles such as good faith or the prohibition to abuse a right that are often embodied in the civil code.⁴³ Neither such maxims nor the terms used for labelling the beneficiary's conduct define clearly the ambit of the fraud exception.

32. As noted by commentators, French courts mostly use the terms "abuse" and "fraud" cumulatively and without clearly distinguishing between them. Inspired by various court decisions, the following distinction was suggested: Fraud implies machination or manoeuvres designed to make the principal pay for what it does not owe, while manifest abuse exists where there is absolutely no doubt that the principal has fulfilled all of its obligations, or where a final court decision has declared the underlying transaction as null and void or terminated it as a consequence of the beneficiary's conduct, or where the beneficiary has stated and admitted that it would not perform the contract.⁴⁴

33. The suggested distinction between fraud and abuse provides a basis for grasping the core of both concepts, even though the description of fraud and the instances of abuse are too narrow to reflect the case law of France and other civil law countries. The definition of fraud as an evil scheme, apparently inspired by criminal law concepts, is reminiscent of the common law concept of egregious or

intentional fraud⁴⁵ and should be understood to include such misconduct as presentation of forged or false documents.⁴⁶

34. Yet, even a fraudulent manoeuvre (such as pressuring the principal to convert conditional bank guarantees issued to a State agency into unconditional ones by promising the release of the principal's managing director who had been imprisoned during negotiations)⁴⁷ may be classified as manifest abuse by courts traditionally preferring that formula. As another French commentator remarked, "whichever form it may adopt, fraud always reveals itself through manifest absence of right of the beneficiary at the time of calling the guarantee."⁴⁸

35. "Absence of right" is not to be taken literally, for example, in the sense that the beneficiary has no right because the guaranty letter is invalid (as to objections to payment concerning validity see paragraphs 76-77 below); the concept of "abuse of right" presupposes the existence of a right and constitutes an inherent limit to the exercise of that right by prohibiting its use without pursuing a legitimate interest or with the sole purpose of violating someone else's interests. As suggested by a Swiss commentator, the core of abuse of right consists of a malicious gain derived from the inadmissible exploitation of one's own unlawful conduct, including breach of contract. Thus, a payment demand would be abusive if the beneficiary has undoubtedly in substantive terms no claim that could be covered by the guarantee purpose.⁴⁹ This concrete formulation of the concept of abuse of right echoes the theme struck by some United States courts: "The beneficiary has no plausible or colorable basis under the contract to call for payment of the letters of credit; its effort to obtain the money is fraudulent."⁵⁰

36. The application of such a concept that restricts the exercise of a formal right to the purpose or substantive contingency determined by reference to the underlying transaction risks jeopardizing the principle of independence of first demand guarantees. This risk has generally been avoided, except by some lower courts, in those jurisdictions that fully recognize the independent and abstract character of the guarantee undertaking; it has clearly diminished in jurisdictions where that recognition was achieved only recently, for example, during the last decade in France and Italy.⁵¹

37. The following decision of the German Supreme Court (in civil matters) may be taken as reflective of the current judicial awareness of the risk and the means to

³⁹Horn/Wymeersch, Bank-Guarantees, Standby Letters of Credit, and Performance Bonds in International Trade, in: *The Law of International Trade Finance* (ed. by Horn, Deventer 1980) pp. 483, 510.

⁴⁰Bertrams, *Bank Guarantees in International Trade* (Amsterdam 1990) p. 280.

⁴¹Costa, "Astrattezza" ed eccezioni opponibili nel credito documentario irrevocabile (Milano 1989) pp. 199-201 (*Il diritto della banca e della borsa*; No. 8).

⁴²Vasseur, *Dix ans de jurisprudence française relative aux garanties indépendantes*, in: *Revue de droit des affaires internationales* 1990, 372.

⁴³E.g. Articles 242, 226 and 826 German Civil Code; Article 2(2) Swiss Civil Code; Articles 1175 and 1375 Italian Civil Code.

⁴⁴Vasseur, *ibid.* (note 42) pp. 373-374; see also Stoufflet, *La garantie bancaire à première demande*, in: *Clunet* 1987, 280.

⁴⁵See, e.g., decisions referred to in notes 6 and 7.

⁴⁶E.g. Richter, *Standby Letter of Credit* (Zurich 1990) p. 251 (see also paras. 63-64).

⁴⁷Oberster Gerichtshof (Austria), 6 June 1989, 31 *Zeitschrift für Rechtsvergleichung* 1990, 290 (injunction denied on other grounds).

⁴⁸Azencot, *Les difficultés d'exécution des garanties bancaires à première demande*, in: 6 *Cahiers juridiques et fiscaux de l'exportation* (1989) p. 1927.

⁴⁹Richter, *ibid.* (note 46) p. 245.

⁵⁰*Itel Corp. v. The First National Bank of Boston*, 730 F. 2d 19 (1984); see also decision referred to in paragraph 16.

⁵¹E.g. Vasseur, *ibid.* (note 42) p. 358.

contain it: "If it is manifest or established by liquid proof that, despite fulfilment of the formal requirements for a demand ('formal contingency'), the substantive contingency in the underlying transaction has not materialized, the demand for payment is unsuccessful because of the defence of abuse of right. However, that defence is to be restricted to those cases where the abusive exploitation of a formal legal position is obvious to everyone. All disputes on factual, but also legal, points that are not answered by themselves must be settled, after payment, in any recovery litigation."⁵² The reason for that restriction lies, as expressed in another decision of the same Court, in the double purpose of a first demand guarantee, which is to provide the creditor with readily available funds and to reverse the procedural position in case of disputes between the principal and the beneficiary.⁵³

38. This double purpose of a first demand guarantee, often referred to as "liquidity function" and, as regards the reversal of the procedural position, expressed by the slogan "pay first, argue (or litigate) later", provides guidance in distinguishing between "abuse of right" and the unwanted involvement of guarantors in contractual disputes between the principal and the beneficiary. Above all, it explains the extraordinary emphasis of courts on the substantive standard of proof, expressed by notions such as "manifest", "obvious to everyone" or "without any doubt". In this respect, courts of the European continent are generally as strict as English courts; however, they are apparently less strict in ordering injunctions, where English courts require notice or knowledge of the bank.⁵⁴

2. Possible instances of manifest fraud or abuse

39. Any test that attaches importance to the risk or contingency covered by the guarantee has to take into account not only the specific purpose of the individual guarantee but also and primarily the type of guarantee (e.g., tender guarantee, repayment guarantee, performance guarantee, maintenance guarantee, financial stand-by letter of credit, counter-guarantee). It may be noted that the following presentation, while focusing on decisions from civil law jurisdictions, includes, for the sake of comparison, occasional references to cases from common law jurisdictions.

(a) Instances concerning tender guarantees

40. To start with the tender guarantee, a demand for payment would be abusive if the contract had not yet been awarded, or had been awarded but not to the principal, or, if awarded to the principal, the principal had signed the contract and secured any required performance

guarantee.⁵⁵ Any of these facts must be made manifest by the principal, unless they are in positive terms set forth in the guarantee as conditions precedent or payment conditions to be established by the beneficiary.

41. In the light of this, a beneficiary that wants more time for evaluating the tenders is unlikely to succeed with a payment demand presented in the form of "extend or pay" and may thus opt for an "extend or withdraw" request⁵⁶ (that falls outside the issue of objections to payment discussed here). A more problematical situation arises when the beneficiary is desirous of accepting the principal's tender but only with certain modifications which the principal regards as unacceptable. While a rigid approach would lead to rejecting the beneficiary's demand as abusive, a less rigid approach was adopted by a French court in ordering the guarantee sum to be paid into a blocked account, while leaving to main proceedings the issue of whether the principal's refusal to accept the modifications was justified.⁵⁷

(b) Lack of advance payment in case of repayment guarantee

42. To mention now repayment guarantees, a demand for payment would be abusive if non-payment of the advance were manifestly established by the principal, while the fact of advance payment would have to be established by the beneficiary if that fact—as frequently done—were set forth in the repayment guarantee as a condition of effectiveness or of payment.

(c) Completion of contract secured by performance guarantee

43. The bulk of decisions in all jurisdictions has been on performance guarantees, including maintenance guarantees. Here, the distinction between fraud or abuse in respect of the guarantee purpose of securing performance and the need to maintain the independence of the undertaking from the underlying transaction is particularly relevant and crucial. Of the various instances relied upon by principals, probably the most successful is complete execution of the underlying transaction to the satisfaction of the beneficiary.⁵⁸ It is no coincidence that this fact has generally been recognized by courts as a basis of fraud or abuse; after all, it constitutes in the guarantee context the equivalent of the complete non-execution of a contract of

⁵²Bundesgerichtshof (Germany), 21 April 1988, *Wertpapier-Mitteilungen* 1988, 935; "liquid proof" is mostly understood as conclusive evidence primarily by means of documents, except affidavits.

⁵³Bundesgerichtshof, 12 March 1984, *Wertpapier-Mitteilungen* 1984, 691.

⁵⁴Bertrams, *ibid.* (note 40) pp. 339, 345.

⁵⁵Similarly Kozolchyk, *Bank Guarantees and Letters of Credit: Time for a Return to the Fold*, 11 *Univ. of Pennsylvania J.Int.Bus.L.* 1989, 21-23 (discussing such instances in the context of the traditional civil law concept of "cause" and agreeing that events constituting essential presuppositions for issuance must affect the validity or enforceability of bonds or guarantees).

⁵⁶Bertrams, *ibid.* (note 40) pp. 208-209.

⁵⁷Tribunal de Commerce de Paris, 29 October 1982, *Dalloz* 1983 I.R. 301. In an unreported Belgian decision, referred to by Bertrams, *ibid.*, a stop-payment order was granted on the grounds that the beneficiary/employer called the guarantee after the expiry date, and because the employer's letter of intent clearly departed from the tender.

⁵⁸E.g. Bertrams, *ibid.* (note 40) pp. 305-308; Horn/Wymeersch, *ibid.* (note 39) pp. 490-492, 502-503, 506; Richter, *ibid.* (note 46) p. 251.

sale (e.g. by shipping worthless rubbish) in the payment context of commercial letters of credit.⁵⁹

44. However, one must hasten to add that the principal's allegation of having completely performed its side of the bargain is far from entitling the guarantor to refuse payment or making a court to enjoin payment.⁶⁰ The fact of completion must "pierce the eyes" ("crêver les yeux"), be "manifest" or "clearly obvious".⁶¹ This was dramatically brought home to a principal, for example, by the French *Cour de Cassation* in holding that, "even if apparently established" that the principal had fulfilled all of its obligations, a stop-payment order would not be granted since there remained a slight uncertainty as to that fact.⁶² In a similar vein, the Court of Appeal of Luxembourg required that the alleged fact be evident without any additional inquiry or verification.⁶³

45. This stringent test would be met only in rare cases where reliable and convincing declarations are presented, such as the beneficiary's definitive declaration of acceptance without further claims,⁶⁴ or the certification of completion by an expert appointed in accordance with the contract between the principal and the beneficiary,⁶⁵ or the declaration of complete performance countersigned by an agent of the beneficiary,⁶⁶ or the beneficiary's statement in a letter accepting the work as correctly executed, while noting that an official certificate of acceptance would be issued and the release of the performance guarantee would take place immediately after the procurement of financial and customs authorizations.⁶⁷

46. In contrast, the test would not be met, for example, where the principal proves only the shipment of the goods but not the beneficiary's acceptance or their conformity with contractual requirements,⁶⁸ or where an expert appointed by the principal certifies completion and elimination of technical defects noticed during the warranty period but where a complaint by the beneficiary prevented the issuance of a certificate of maintenance,⁶⁹ or where the principal and the beneficiary are involved in negotiations or litigation concerning contractual disputes.⁷⁰

⁵⁹See cases referred to in paragraph 28 and note 8.

⁶⁰E.g. *Cour d'Appel de Paris*, 15 February 1989, *Dalloz* 1989 Somm. 159 (reversing the decision of a commercial judge in summary proceedings that had based a stop-payment order on the finding that the circumstances of the case made it appear that there was the risk of an element of fraud).

⁶¹E.g. Vasseur, *ibid.* (note 42) p. 372.

⁶²*Cour de Cassation*, 21 May 1985, *Dalloz* 1986, I.R. 213 (with a note by Vasseur).

⁶³*Cour d'Appel de Luxembourg*, 16 March 1983, *Dalloz* 1983, I.R. 299.

⁶⁴E.g. *Cour de Cassation*, 10 June 1986, *Dalloz* 1987, 17.

⁶⁵E.g. *Cour de justice civile de Genève*, 12 September 1985, *Dalloz* 1986 I.R. 165.

⁶⁶E.g. *Pretore Bologna*, 28 March 1981, *Banca, borsa e titoli di credito* 1983 I p. 119.

⁶⁷E.g. *Pretore Roma*, 11 May 1987, *Foro padano* 1987 I p. 397.

⁶⁸E.g. *Pretore Milano*, 28 June 1982, *Banca, borsa e titoli di credito* 1983 II p. 110.

⁶⁹E.g. *Tribunale Milano*, 30 April 1987, *Banca, borsa e titoli di credito* 1988 II p. 3.

⁷⁰E.g. *Landgericht Köln*, 11 December 1981, *Wertpapier-Mitteilungen* 1982, 438.

47. The test may be less stringent in those cases where, in addition to probable completion, other elements point to the abusive or fraudulent nature of the demand. For example, an Italian judge regarded the principal's detailed certification of completion as relevant since the beneficiary had not made any substantial complaint about the quality of the works and its demand for payment was obviously motivated by the principal's refusal to make certain modifications and improvements not envisaged in the original contract.⁷¹ The additional element may be labelled as "different risk or purpose" and has been widely recognized as an instance of abuse of right.⁷²

(d) Different risk or purpose

48. A payment demand for a purpose other than that for which the undertaking was given may be viewed as abusive since it falls outside the purpose or risk intended by the parties.⁷³ Demands falling outside the covered risk may take various forms. The beneficiary may, for example, intend to reclaim a loan by calling a guarantee that was to secure payment of works,⁷⁴ or to recover losses suffered in a transaction other than the one secured by the guarantee,⁷⁵ or to recoup under a performance guarantee the banking fees charged to the beneficiary.⁷⁶

49. Another form of abuse, constituting partial abuse, would be to demand payment under all guarantees covering the individual instalments of a delivery contract while alleging default only in respect of some instalments,⁷⁷ or to call a number of performance guarantees covering different transactions although all but one have been properly performed.⁷⁸ It may be noted that this form of partial abuse was recognized in principle by an English court but not held to be sufficiently proven in the case at hand: "We therefore conclude that, although the plaintiffs have provided, on the available material, a seriously arguable case that there is good reason to suggest, certainly in regard to some of these contracts, that the demands on the performance bonds have not been honestly made, they have not established a good arguable case that the only realistic inference is that the demands were fraudulent."⁷⁹

50. Yet another form of abuse under the rubric "different risk or purpose" would be, as in the case referred to

⁷¹*Tribunale Milano*, 12 October 1985, *Banca, borsa e titoli di credito* 1986 IV p. 430.

⁷²E.g. Horn/Wymeersch, *ibid.* (note 39) pp. 495, 500, 503.

⁷³E.g. Kleiner, *Bankgarantie* (4th ed., Zurich 1990) pp. 199-200 (referring to two Zurich decisions).

⁷⁴*Oberster Gerichtshof, Evidenzblätter* (decisions of OGH) 1982, 23.

⁷⁵E.g. *Tribunal de Commerce de Bruxelles*, 26 May 1988, *Journal des Tribunaux* 1988, 460 (restraining order based also on other grounds).

⁷⁶*Tribunal de Commerce de Paris*, 24 January 1984, *Dalloz* 1984 I.R. 203.

⁷⁷*Oberster Gerichtshof*, 17 March 1986, *Recht der Wirtschaft* 1986, 340.

⁷⁸*Tribunal de Commerce de Bruxelles*, 21 October 1986, *Revue Droit Commercial Belge* 1987, 706 (Stop-payment orders were granted in respect of three, out of four, guarantees covering properly performed transactions.)

⁷⁹*United Trading Corp. v. Allied Arab Bank Ltd.*, *ibid.* (note 31) p. 565.

in paragraph 47, to put pressure on the principal to make certain concessions. For example, a Belgian judge declared a payment demand as abusive since it was used as a technique to extort a price revision from the principal.⁸⁰ Similarly, an Austrian court regarded as abusive the threat to demand payment aimed at stopping the principal from initiating litigation against the beneficiary concerning a different transaction.⁸¹ The element of pressure may also be found in the common practice of "extend or pay" requests.

(e) "Extend or pay" requests

51. Reportedly, banker's estimate that well over 90 per cent of the calls on first demand guarantees concern "extend or pay" requests; it is not unusual that such requests are lodged over and over again, carrying the repeatedly extended expiry date far beyond the initial expiry date.⁸² If the alternative demand for payment is not merely threatened and if it is made in conformity with the requirements as to form and accompanying documents, one might regard the demand as abusive since it is not a straightforward, unconditional demand or because it is contradictory in itself: either the risk covered has materialized, in which case no extension would be needed, or it has not yet materialized, in which case the demand would fall outside the intended purpose. Thus, where the principal does not agree to the extension or does not respond at all, a later, unqualified demand made after the expiry date was held to be too late.⁸³

52. However, such a view would not be appropriate as a general response to a payment request coupled with an alternative request for extension of the validity period. After all, the request may be made for good reasons and aim, for example, at giving the principal additional time for completing performance, at allowing the parties to the underlying transaction more time for settling contractual disputes, or at enabling the beneficiary to consider its final stand on whether and for what amount to demand payment. Yet, the request might also be made in bad faith, for example, where the beneficiary itself has made the principal's performance impossible or where the motive of the request is to put pressure on the principal to make concessions and, for example, agree to an extended warranty period or to execute works or modifications in excess of the original contract.⁸⁴

53. Since the request for extension is in substance addressed to the principal and since the principal is in the best position to judge whether the alternative demand for payment is abusive and whether that abuse can be

promptly established, the guarantor should immediately upon receipt of an "extend or pay" request inform the principal; if the principal does not consent to the extension or does not make it manifest to the guarantor that the payment demand constitutes an abuse of right, the guarantor should make payment within the legal period of time (still to be determined for the uniform law; see A/CN.9/WG.IV/WP.68, paras. 58-60).

54. It may be noted that a similar approach has been adopted by the draft Uniform Rules for Demand Guarantees of the International Chamber of Commerce. Article 26 URDG reads:

"If the Beneficiary requests an extension of the validity of the Guarantee as an alternative to a claim for payment submitted in accordance with the terms and conditions of the Guarantee, the Guarantor shall without delay so inform the party which gave the Guarantor his instructions. The Guarantor shall then suspend payment of the claim for such time as is reasonable to permit the Principal and the Beneficiary to reach agreement on the granting of such extension and for the Principal to arrange for such extension to be issued.

Unless an extension is granted within the time provided by the preceding paragraph, the Guarantor is obliged to pay the Beneficiary's conforming claim without requiring any further action on the Beneficiary's part. The Guarantor shall incur no liability (for interest or otherwise) should any payment to the Beneficiary be delayed as a result of the above-mentioned procedure.

Even if the Principal agrees to or requests such extension, it shall not be granted unless the Guarantor and the Instructing Party(ies) also agree thereto."⁸⁵

(f) Secured obligation non-existent, invalid, illegal or unenforceable

55. There are various instances where a demand for payment might be regarded as fraudulent or abusive even though the principal has obviously or admittedly not fulfilled the secured obligation. One such instance would be where, at the time of the demand, performance is not yet due,⁸⁶ unless there was an anticipatory breach of contract. Another such instance, not limited to performance guarantees, is where the beneficiary promises the principal to release the guarantee or where such release forms part of a settlement agreement between the principal and the beneficiary.⁸⁷ It may be noted that there is no need for

⁸⁰Président du Tribunal de Gand, 27 December 1983, *Tijdschrift Belgisch Handelsrecht* 1986, 298.

⁸¹Oberster Gerichtshof, *ibid.* (note 77).

⁸²Bertrams, *ibid.* (note 40) p. 207; see also Stoufflet, *ibid.* (note 44), 280.

⁸³E.g. *Cour d'Appel de Paris*, 2 April 1987, *Dalloz* 1988 *Somm.* 248, upheld by *Cour de Cassation*, 24 January 1989, *Dalloz* 1989 *Somm.* 159. Similarly, *Esal (Commodities)*, *Reltor v. Oriental Credit*, [1985] 2 *Lloyd's Rep.* 546.

⁸⁴E.g. Kozolchik, *ibid.* (note 55) pp. 31-32; Bertrams, *ibid.* (note 40) p. 207.

⁸⁵Revised text of the Uniform Rules for Demand Guarantees, ICC Document No. 460/470-1/19 BIS and 460/470-10/1 BIS of 8 February 1991; this draft text constitutes the recent version of the earlier ICC draft Uniform Rules for Guarantees that had been reviewed by the Working Group at its twelfth session (A/CN.9/316).

⁸⁶E.g. *Cour d'Appel de Paris*, 2 June 1982, *Dalloz* 1983 *J.* 437.

⁸⁷E.g. von Westphalen, *Die Bankgarantie im internationalen Handelsverkehr* (2nd ed., Heidelberg 1989) p. 183; it may be noted that the defence of release was in principle recognized by the English Court of Appeal in *Boliventer Oil S.A. v. Chase Manhattan Bank*, [1984] 1 *Lloyd's Rep.* 251; however, fraud in terms of bad faith was not held to be proven since the beneficiary might have, rightly or wrongly, considered in the circumstances that its agreement to release the guarantee had been obtained under commercial pressure.

invoking fraud or abuse where the beneficiary declares the guarantor's release from liability since such act within the guarantor-beneficiary relationship terminates the guarantor's payment obligation.⁸⁸

56. Other instances that principals might wish to rely on are the invalidity of the underlying transaction or the expiry of the prescription or limitation period of the principal's obligation. While a decade ago courts occasionally held otherwise,⁸⁹ the judicial attitude is generally to reject such reliance, unless the lack of a valid underlying transaction has been determined in a final decision by a court or arbitral tribunal.⁹⁰ It may be noted that this latter exception is not limited to findings of invalidity but extends to other decisions that terminate or deny the principal's obligation.⁹¹

57. However, the situation is less clear where the underlying transaction violates public policy or is otherwise illegal. While it seems to be generally accepted that the beneficiary cannot claim payment if the underlying transaction violates public policy, there is hardly any case law that would provide guidance.⁹² A French commentator suggested to distinguish between manifest violation of public policy, in which case payment by the guarantor would intolerably contribute to the implementation of a clearly illegal transaction, and instances of uncertain or doubtful violation of public policy, where payment would accord with the purpose of the guarantee to change the procedural position of the parties.⁹³ While this distinction is in line with the general standard of "manifest abuse", it is submitted that a court would apply a less stringent standard and carefully examine the matter *ex officio* with a view to ensuring compliance with the forum rules on public policy.⁹⁴

58. It may be noted that there is no need for invoking the concept of fraud or abuse where the guarantee itself is affected by the violation of public policy since in that case the right to refuse payment follows from the invalidity or, in case of violation of article VIII of the Bretton Woods Agreement, unenforceability of the payment obligation (see paragraphs 78-79 below). As regards the remaining instances of illegality affecting merely the underlying

transaction, special considerations apply where that illegality results from the law of the principal's country that is different from that of the guarantor or the beneficiary. Since the beneficiary will often not be familiar with regulations in the principal's country restricting, for example, import or export or foreign currency exchange, the possible illegality of the underlying transaction may be regarded as one of the risks intended to be covered by the guarantee.⁹⁵ If a principal would nevertheless want to rely on that illegality, it would seem almost impossible to make the alleged abuse obvious or manifest to the guarantor in view of the difficult legal issues involved, including the controversial effect of foreign mandatory laws and the absence of any earlier breach of a duty to advise the beneficiary of the legal impediments to the transaction and its performance.

(g) *Other instances of allegedly justified non-performance*

59. The latter considerations apply with similar force to various other instances of allegedly justified non-performance by the principal. Since the legal consequences freeing the principal from its obligation vary depending on the particular contract and the applicable law, the instances may appropriately be grouped according to the fact situations relied upon by the principal.

60. A first group comprises circumstances surrounding the conclusion of the underlying transaction, for example, mistake, misrepresentation or duress. Such circumstances that would entitle the principal to avoid the contract or, in certain jurisdictions, lead *eo ipso* to the above discussed invalidity of the contract, have been recognized as possible basis of abuse; however, injunctions were usually not granted because the principal did not overcome the extreme difficulty of establishing within the constraints of preliminary proceedings the facts and legal consequences thereof.⁹⁶

61. A second group comprises acts or omissions by the beneficiary that principals often claim entitle them to rescind the underlying transaction or to suspend performance. The beneficiary's demand for payment was held to be abusive, for example, where the beneficiary itself had impeded performance⁹⁷ or unilaterally avoided the contract without cause.⁹⁸ While case law does not appear

⁸⁸According to Article 23 URDG, "a Guarantee shall be cancelled prior to the Expiry Date or Expiry Event on presentation to the Guarantor of . . . the Beneficiary's written statement of release from liability under the Guarantee, whether or not the Guarantee or any amendments thereto are returned".

⁸⁹E.g. Tribunale Pavia, 17 February 1981, *Foro padano* 1982, 88.

⁹⁰E.g. *Cour de Cassation*, 20 December 1982, *Dalloz* 1983 J.365; von Westphalen, *ibid.* (note 87) p. 180 (see also above, para. 32).

⁹¹E.g. *Cour d'Appel de Paris*, 13 December 1984, *Dalloz* 1985 I.R.239.

⁹²E.g. Bertrams, *ibid.* (note 40) p. 317 (referring to *Cour d'Appel de Bruxelles*, 18 December 1981, *Revue de la Banque* 1982, 99); it may be noted that the English Court of Appeal reserved its position in respect of a claim relating to a clause in the underlying transaction that constituted a penalty, which is null and void under English law (*Dodds PVT Ltd. v. Kingpull Ltd.*, 1 July 1985, unpublished, referred to by Elland-Goldsmith, *Garantie Bancaire: L'évolution de la jurisprudence en Angleterre*, *Revue de droit des affaires internationales* 1990, 434).

⁹³Vasseur, note, *Dalloz* 1984, 421.

⁹⁴E.g. *Bundesgerichtshof*, 28 April 1988, *Recht der internationalen Wirtschaft* 1988, 558.

⁹⁵E.g. Bertrams, *ibid.* (note 40) p. 317.

⁹⁶Bertrams, *ibid.* (note 40) p. 304 (referring, e.g., to *Rechtbank Amsterdam*, 20 December 1984, *Kort Geding* 1985, 21; *Rechtbank Haarlem*, 21 November 1986, *Kort Geding* 1987, 57; *DTH Construction v. Steel Authority of India*, *International Business Lawyer* 1986, 175; *Cromwell v. Commercial & Energy Bank*, 40 UCC Rep. Serv. 1814 (La. 1985); *Brown v. United States National Bank*, 41 UCC Rep. Serv. 1765 (Neb. 1985)).

⁹⁷E.g. *Landgericht Frankfurt*, 11 December 1979, *Wertpapier-Mitteilungen* 1981, 284 (delivered machinery neither installed nor examined by beneficiary); *Rechtbank Zwolle*, 26 November 1982, *Kort Geding* 1982, 220 (performance of purchase obligation under exclusive dealership agreement made impossible by beneficiary's breach of exclusivity).

⁹⁸E.g. *Tribunal de Commerce de Bruxelles*, 15 January 1980, *Jurisprudence Commerciale Belge* 1980, 147; *Tribunal de commerce de Paris*, 15 March 1985, *Dalloz* 1985 I.R. 244.

to provide clear guidance as to the instances justifying a finding of abuse, one may generally say that the beneficiary's misconduct must be serious, jeopardizing the entire transaction or constituting a breach of a fundamental obligation.⁹⁹ As in respect of other possible instances of abuse, the alleged facts and legal consequences would have to be made manifest or obvious, and, as regards injunctive relief, restraining orders against beneficiaries are less difficult to obtain than stop-payment orders against guarantors, especially issuers of indirect guarantees.¹⁰⁰ Similar considerations apply where the principal bases its right to avoid the contract or suspend performance on the fact that the beneficiary failed to pay due instalments of the contract price.¹⁰¹

62. A third group comprises instances where performance is impeded not by the beneficiary's conduct but by supervening events qualified as *force majeure* or Act of God that may free principals from their obligation or entitle them to avoid the contract (e.g., embargo, blocking of foreign currency funds and similar State interventions, or natural disasters). Reliance on such an event for the purpose of showing manifest abuse would require the establishment of not only the occurrence of the event and the impossibility of foreseeing or overcoming it but also of the legal certainty about its qualification as *force majeure* under the contract and the applicable law, including its effect of freeing the principal from its obligation according to the risk allocation under the contract and the absence of any remaining liability that might fall within the risk covered by the guarantee.¹⁰² It seems almost impossible that all those complex points will ever be manifest or obvious to a guarantor, and principals have very rarely been successful in summary proceedings for injunctive relief.¹⁰³

(h) *Presentation of forged or fraudulent document*

63. A demand for payment is fraudulent or abusive if it is based on a wrongful act such as presentation of a forged or fraudulent document. Payment under guarantees is, however, not often conditioned on the presentation of documents, even if one were to include statements by the beneficiary about the principal's default. Moreover, any documents required would not have the commercial value of a bill of lading as may be required under a traditional letter of credit so that any considerations concerning the

bank's interest in obtaining a document of such value (see paragraphs 25-26 above) are not applicable to guarantees or stand-by letters of credit.

64. It is submitted that the above basis of a fraudulent or abusive demand for payment constitutes, in practical terms, an addition to the previously discussed instances in the following procedural or evidentiary respects. Where the beneficiary presents a forged document, payment should be refused if the guarantor itself detects the forgery or if it is made manifest, for example, by a denial of the purported author. Where the document is fraudulent in certifying wrongly the principal's default, the burden of establishing abuse would be limited to the instance of default as described in the document. For example, if the payment demand under a tender guarantee is based on a statement that the successful tenderer did not secure the required performance guarantee, all that needs to be made obvious or manifest is the issuance of the required performance guarantee; the beneficiary would be precluded from later justifying its demand by the refusal of the principal to sign the awarded contract. In contrast, where the beneficiary calls a tender guarantee payable on simple demand, the showing of abuse in terms of lack of any colourable or plausible basis would have to include the fact that the principal either was not awarded the contract or had accepted the contract as determined in the tender conditions. Thus, the advantage of requiring a statement by the beneficiary is not merely to provide a psychological barrier by "forcing it to lie" but to shorten the "plausible basis", in particular where a statement is required as to the respect in which the principal defaulted.

(i) *Special considerations for counter-guarantees*

65. The above instances of possible fraud or abuse relating to the underlying transaction between the principal and the beneficiary may constitute an objection to payment by any guarantor that issued or confirmed a guarantee to that beneficiary, be it a direct guarantee issued at the request of the principal or be it an indirect one issued on the instructions of an instructing party acting at the principal's request. However, where an indirect guarantee is counter-guaranteed by the instructing party, special considerations apply to the issue of fraud or abuse as a possible objection to payment by the counter-guarantor (hereinafter referred to as "first bank").

66. The reason therefor lies in the fact that the beneficiary of the counter-guarantee is the issuer of the indirect guarantee (hereinafter referred to as "second bank") and not the above beneficiary that is linked with the principal by the underlying transaction. Any fraud or abuse by that latter beneficiary (hereinafter referred to as "ultimate beneficiary") would be that of a third party and thus not directly relevant to the relationship between the first and the second bank. It is exclusively within that relationship that the issue of fraud or abuse as an objection to payment under the counter-guarantee is to be determined, taking into account its purpose of indemnifying the second bank according to the terms and conditions of the counter-guarantee.

⁹⁹E.g. Bertrams, *ibid.* (note 40) pp. 311-312.

¹⁰⁰E.g. *Rechtbank Leeuwarden*, 6 October 1986, *Kort Geding* 1986, 476.

¹⁰¹Stop-payment orders were granted, e.g. *Cour d'Appel de Versailles*, 1 December 1988, *Dalloz* 1989 *Somm.* 155; *Pennsylvania State Const. Inc. v. Cambria Savings & Loan Association*, 2 UCC Rep. Serv. 2d 1638 (Pa. 1987).

¹⁰²E.g. Bertrams, *ibid.* (note 40) pp. 315-316.

¹⁰³E.g. *Tribunal de Commerce de Bruxelles*, 6 April 1982, *Revue de la Banque* 1982, 683; *Rechtbank Amsterdam*, 18 December 1980, *Schip and Schade* 1981, 135; *Dynamics Corp. v. Citizens & Southern National Savings Bank*, *ibid.* (note 10); injunction not granted, e.g., *State Trading Corp. of India v. E.D. & F. Man*, *The Times* 22 July 1981 (principal did not show that beneficiary did not honestly believe in principal's unexcused default).

67. For example, if payment by the first bank is conditioned on a statement by the second bank that the ultimate beneficiary has demanded payment by the second bank, presentation of an untrue statement would, if obvious or manifest to the first bank, constitute a basis for objecting to payment. The same would apply in the probably less common case where payment by the first bank is due upon certification by the second bank that it has already paid the ultimate beneficiary.

68. Considerably more difficult are those cases where the conduct of the ultimate beneficiary may be regarded as fraudulent or abusive. While it is generally accepted that in case of collusion between the ultimate beneficiary and the second bank payment may be refused by the first bank, provided that the collusive behaviour is evident,¹⁰⁴ there is no uniformity as to whether or under what circumstances the fraud exception applies to the counter-guarantee outside the rare instance of collusion. While some decisions appear to leave no room for the fraud exception outside the instance of collusion,¹⁰⁵ others lean towards the opposite extreme by according relevance to the ultimate beneficiary's fraud without considering the second bank's position and, in particular, whether it was aware of that fraud when demanding reimbursement from the first bank.¹⁰⁶ The prevailing judicial attitude lies between these two extremes and may be labelled as "double abuse"¹⁰⁷: The first bank may refuse payment if it is evident that the second bank, before paying the ultimate beneficiary, was aware of the fraud or abuse by the ultimate beneficiary.¹⁰⁸

69. The abuse by the second bank would lie in its demanding reimbursement despite the fact that it was entitled, and towards the instructing party obliged, to refuse payment to the ultimate beneficiary. What needs to be established therefore is not only the misconduct or other basis of fraud or abuse on the part of the beneficiary and the second bank's awareness thereof but also the legal consequences concerning the qualification as fraud or abuse and the ensuing duty of the second bank to refuse payment.

70. As regards the legal consequences, the matter is complicated by the fact that different laws might have to be applied and their answer made manifest to the first bank. In all likelihood, the issue of the recognition of fraud or abuse of the ultimate beneficiary is to be determined by the law of the State where the second bank has its place of business and thus, from the perspective of the first bank and the principal, by a foreign law that is difficult to assess. The question of whether the second bank owes a duty of care towards the first bank (and possibly indirectly to the principal) may have to be determined by that same foreign law or by the law of the State where the

first bank has its place of business, in part depending on whether the duty may be based on contract or tort (see paragraphs 98-99 below).

71. As was concluded from a survey of about 60 decisions dealing with (alleged) fraud in cases involving indirect guarantees, "courts very rarely bother to raise the issue of private international law" and "those courts which perfunctorily noted that the guarantee was covered by foreign law evidently applied their own, but not necessarily provincial, notions of fraud."¹⁰⁹ It was also concluded that the rule requiring evidence of the second bank's knowledge of the ultimate beneficiary's fraud, while consistently followed by English courts, is not as firmly entrenched in Continental case law as it is in legal writing. While in some decisions the finding in respect of the second bank's knowledge was based on solid evidence,¹¹⁰ some courts appear not to have given any consideration to the second bank's position and others, once satisfied with the evidence concerning the ultimate beneficiary's fraud, inferred the second bank's awareness from facts that were not always revealed or conclusive.¹¹¹

72. It is submitted that a provision in the uniform law determining the relevance of the ultimate beneficiary's fraud or abuse to the payment obligation of the first bank would constitute a particularly useful contribution to the desired legal uniformity and certainty. In addition to determining the relevance, including the requirements of the fraud exception within the relationship between the first and the second bank, the complex procedural issues of possible injunctions against the first and the second bank need to be addressed (see paragraphs 90-114 below).

C. Tentative conclusions

73. It is hoped that the above discussion of fraud, abuse and similar concepts and of their application by courts of various jurisdictions is, despite its fragmentary and general nature, of assistance to the Working Group in its deliberations. While a number of considerable disparities have become apparent, there exists a remarkable degree of similarity within the selected jurisdictions where courts, especially during the last decade, have developed and refined the law relating to the fraud exception in respect of independent guarantees and stand-by letters of credit.¹¹² However, even within a given jurisdiction one would find more disparity and uncertainty if one were to examine all decisions with their great variety of facts and procedural settings. Above all, there are many remaining jurisdictions where courts did not yet have the opportunity to develop and refine the law.

¹⁰⁴E.g. *Cour de Cassation*, 11 December 1985, *Dalloz* 1986, 214; *Bundesgerichtshof*, 12 March 1984, *Wertpapier-Mitteilungen* 1984, 689.

¹⁰⁵E.g. *Cour d'Appel de Paris*, 21 January 1987, *Dalloz* 1987 I.R. 176.

¹⁰⁶E.g. *Landgericht Dortmund*, 9 July 1980, *Wertpapier-Mitteilungen* 1981, 280; *Cour d'Appel de Paris*, 2 June 1982, *Dalloz* 1983, 437; *Cour d'Appel de Paris*, 18 November 1986, *Dalloz* 1988 *Somm.* 247.

¹⁰⁷E.g. von Westphalen, *ibid.* (note 87) p. 252.

¹⁰⁸E.g. *Bundesgerichtshof*, *ibid.* (note 104); *Cour de Cassation*, 10 June 1986, *Dalloz* 1987, 17.

¹⁰⁹Bertrams, *ibid.* (note 40) p. 351.

¹¹⁰E.g. *Cour de justice civile de Genève*, 12 September 1985, *Dalloz* 1986 I.R. 165 (knowledge evidenced by stop-payment order of local court against second bank); *Landgericht Düsseldorf*, 9 August 1984, *Recht der internationalen Wirtschaft* 1985, 77 (knowledge evidenced by second bank's receipt of a copy of an arbitral award ordering the beneficiary to return the guarantee).

¹¹¹Bertrams, *ibid.* (note 40) pp. 353, 355.

¹¹²E.g. Horn/Wymeersch, *ibid.* (note 39) p. 529.

74. It is for all these reasons that the Working Group may wish to prepare provisions on the fraud exception that would provide legal certainty and uniformity. In its search for acceptable solutions, it may draw inspiration from the requirements or tests developed in certain jurisdictions. It is submitted, however, that to prefer one test to another, or to opt for a stricter requirement rather than a less stringent one, is not a question of right or wrong but depends essentially on what the precise scope of the fraud exception should be in the light of the conflicting interests of the parties involved. Moreover, what counts is not so much the individual requirement but the totality of the rules on the fraud exception, as illustrated by the rather generous recognition of instances of abuse in civil law jurisdictions that is offset or filtered by such requirements as "manifest", "obvious" or "established by liquid proof".

75. With a view to devising acceptable provisions on the fraud exception, the Working Group may wish to consider the following questions:

1. What conduct of the beneficiary or other facts constitute fraud or abuse?

(a) Should a general definition be restricted by a subjective criterion (e.g., evil intent, dishonesty, bad faith) or should it, following the prevailing judicial attitude, be based on objective criteria that may be more easily established (e.g., lack of plausible basis, purpose of demand falls outside the covered risk)?

(b) Should a general definition be accompanied by a list of instances that may qualify as a basis of fraud or abuse (taking all or some of the instances discussed in paragraphs 39-72) and, if so, should that list be illustrative or exhaustive?

2. What is the substantive standard of proof?

(a) As regards the degree of awareness entitling the guarantor to refuse payment, should any of the above terms (e.g., evident, certain, obvious to everyone, manifest or established by liquid proof) be used or may another appropriate term be found?

(b) Should that standard be limited to the issue of the guarantor's refusal on its own motion or should it apply equally to court orders enjoining payment by the guarantor or restraining the beneficiary from demanding or receiving payment? (Consideration of this question might appropriately be dealt with after the discussion of the procedural aspects of injunctions, see paragraphs 90-114 below).

3. What special considerations apply to the fraud exception available to a counter-guarantor in cases involving fraud or abuse by the ultimate beneficiary?

(a) Should any such fraud or abuse be relevant where there is no collusion between the ultimate beneficiary and the second bank?

(b) If so, what should be the requirements for recognizing the ultimate beneficiary's conduct as a basis for the fraud exception available to the first bank/counter-guarantor (e.g., knowledge of second bank, recognized right of second bank to refuse payment, duty of second bank to refuse payment, certainty of second bank as to ability to establish the previous

points in any proceedings with the ultimate beneficiary, knowledge of first bank of all previous points)?

4. What kind of persons should be protected against the fraud defence?

(a) Is the innocent beneficiary protected and, if so, under what circumstances?

(b) As regards other persons (e.g., transferee, protected holder of bill of exchange), is, for example, the approach suggested by the Task Force on Article 5 UCC (paragraph 18 above) appropriate for the uniform law?

II. OTHER OBJECTIONS TO PAYMENT

A. Invalidity, voidability or unenforceability of payment obligation

76. Where a demand is made in conformity with the terms and conditions of the guaranty letter and the payment obligation has not ceased by termination, release or discharge before the expiry date, there may be other objections to payment than the previously discussed fraud exception. A basic ground for refusing payment would be that the guarantor's undertaking is void or voidable under the law applicable to questions of material validity. Legal consequences of this kind may ensue from acts of the beneficiary (e.g., duress, deceit, misrepresentation) or from facts falling in the guarantor's realm (e.g., mistake).¹¹³

77. Depending on the particular applicable law, such legal consequences may also follow from the fact that the payment undertaking or its fulfilment would be contrary to public policy, in violation of a legal prohibition, immoral or for similar reasons illegal.¹¹⁴ However, at least some such reasons may in other jurisdictions not lead to invalidity but to unenforceability of the payment undertaking, or possibly to impossibility of performance with varied consequences. An illustration thereof would be the violation of a national law on currency, if the guarantee sum is payable in local currency, or on foreign exchange, if it is payable in foreign currency. It might be submitted, in this context, that any restriction or prohibition of foreign currency exchange precluding the guarantor from receiving reimbursement from the principal would be as irrelevant to the guarantor's payment obligation as, for example, the principal's insolvency.¹¹⁵

78. Another example that courts have had to deal with is the violation of Article VIII, paragraph 2(b) of the Bretton Woods Agreement.¹¹⁶ As noted earlier (para-

¹¹³E.g. von Westphalen, *ibid.* (note 87) p. 175; Richter, *ibid.* (note 46) p. 225.

¹¹⁴*Idem.*

¹¹⁵E.g. von Westphalen, *ibid.* (note 87) p. 179; Richter, *ibid.* (note 46) p. 224.

¹¹⁶Article VIII(2)(b) reads in its relevant part: "Exchange contracts which involve the currency of any Member and which are contrary to the exchange control regulations of that Member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any Member".

graphs 57-58 above), if such violation affects merely the underlying transaction (e.g., payment obligation in a sales or works contract), it might constitute the source of an abusive demand under the guarantee; however, if the violation of that Agreement extends to the guarantor's undertaking, payment would be refused because the undertaking is regarded either as invalid or as unenforceable.¹¹⁷

79. As decided by the House of Lords, the same applies in the case of a commercial letter of credit even if the underlying sales contract, qualified in part as a "monetary transaction in disguise", is not illegal under the law of the State where it would be performed by paying the letter of credit (here: English law); it was added that the "bank, if it had known . . . of the monetary transaction by the buyer that was involved, could have successfully resisted payment . . . but . . . there was nothing in English law to prevent it from voluntarily paying . . ."¹¹⁸ As regards this latter conclusion, it is submitted that courts in other jurisdictions might hold otherwise and recognize in such circumstances a duty of the bank to refuse payment.¹¹⁹

B. Set-off with claims of guarantor

80. The possibility of invoking a claim against the beneficiary by way of set-off may be discussed here as an objection to payment, even though it does not constitute a denial of the legitimacy of the beneficiary's demand but may be viewed as a mode of discharging a debt. In discussing the admissibility of a set-off, a distinction should be drawn between the guarantor's own claims and any claim assigned to it by the principal, which would usually relate to the underlying transaction.

81. Starting with the latter kind of claim, the widely prevailing judicial attitude is not to allow a set-off by the guarantor even if the general requirement of a set-off were met, namely that the claim be liquidated and certain or undisputed.¹²⁰ However, courts have occasionally held otherwise.¹²¹ It may be mentioned, in this context, that the fact that the principal has a liquid or certain claim, arising from the underlying transaction and not assigned to the guarantor, has been regarded, often together with completion of the principal's contractual obligation, as a possible basis for fraud or abuse.¹²²

82. Turning now to the guarantor's own claims, a first clarification that somewhat limits the problem is to point to the relevance of any clause that either allows or precludes a set-off by the guarantor. Clauses expressly allowing a set-off are probably very rare in guarantees or stand-by letters of credit; however, they may be found in surrounding bank contracts, including general conditions,

for example, between the second bank and the ultimate beneficiary in the case of an indirect guarantee or, in respect of a counter-guarantee, between the first and the second bank. As regards this latter relationship, it has been suggested that the issue of set-off should be decided in accordance with international banking practices.¹²³ Clauses expressly prohibiting set-off by the guarantor are probably rare. Whether a prohibition may be derived from general expressions such as "waiving any defences" or "without any condition or defence" is at least doubtful; it is submitted that the answer should be the same as in the case of any other guarantee payable on first demand.

83. The answer given by courts and by commentators is by no means uniform. One view is to disallow set-off since the guarantor, when carrying out its task that is based on a request of the principal or instructing party, should not be guided by its own interest and since the beneficiary, in view of the security and liquidity function of the first demand guarantee, is entitled to actual payment.¹²⁴ Moreover, to allow set-off might mean that beneficiaries would not easily accept guarantees from banks with which they may have contacts or that a dissatisfied beneficiary might take retaliatory measures against the principal.

84. Another view, often based on general legal rules about the admissibility of set-off, is to allow the guarantor to discharge its payment obligation by a set-off with its own claims since the liquidity function of the guarantee has no bearing on the issue of set-off but only on that of fraud or abuse.¹²⁵ A similar reason was given by an English judge in a case where a network of financial transactions included a stand-by letter of credit: "There are two striking features of the present case. First, the stand-by letter of credit was opened for the specific purpose of financing the liabilities on the dry cargo transactions, so that it would seem very unjust if the bank were precluded from enforcing a set-off in relation to the present claims which arise directly out of selfsame transactions. Secondly, this is a liquidated set-off, and it would seem to me anomalous that such a set-off should be unavailable in letters of credit cases, but available against bills of exchange which are closely analogous in that a bill of exchange is also virtually equivalent to cash."¹²⁶

85. An intermediate view is to allow set-off only in certain circumstances. It was held, for example, that the general preclusion of set-off, based on an implied exclusion agreement, would not apply where the beneficiary was insolvent and the bank would otherwise probably be

¹¹⁷E.g. von Westphalen, *ibid.* (note 87) p. 181.

¹¹⁸UCM (*Investments*) v. *Royal Bank of Canada*, *ibid.* (note 33) pp. 729-730.

¹¹⁹E.g. von Westphalen, *ibid.* (note 87) p. 181.

¹²⁰E.g. *Bundesgerichtshof*, 14 October 1982, *Wertpapier-Mitteilungen* 1982, 1324; *Rechtbank Haarlem*, 9 January 1987, *Kort Geding* 1987, 85.

¹²¹E.g. *Rechtbank Amsterdam*, 7 March 1985, *Kort Geding* 1985, 87.

¹²²E.g. von Westphalen, *ibid.* (note 87) pp. 396-397; Bertrams, *ibid.* (note 40) p. 322.

¹²³Bertrams, *ibid.* (note 40) p. 271 (pointing at the difficulty that at present well-established practices do not appear to exist and that the law governing set-off is not easily determined, bearing in mind that the counterclaim and the claim for reimbursement might be subject to different laws).

¹²⁴E.g. *Landgericht Frankfurt*, 21 September 1983, *Wertpapier-Mitteilungen* 1984, 86; Richter, *ibid.* (note 46) p. 225; Bertrams, *ibid.* (note 40) pp. 269-270.

¹²⁵E.g. *Tribunal de Commerce de Bruxelles*, 18 April 1985, *Revue Droit Commercial Belge* 1985, 729; Kleiner, *ibid.* (note 73) p. 198.

¹²⁶*The Hong Kong and Shanghai Banking Corp. v. Kloeckner & Co. A.G., Q.B.*, [1989] 2 *Lloyd's Rep.* 323, 331 (per Hirst J.).

unable to realize its claim.¹²⁷ The German Supreme Court held that set-off was permissible in the case of a payment guarantee, securing payment of the purchase price, since such guarantee served primarily the security function and, apart from that, there was no reason to assume that the beneficiary should be accorded a better position than the one it would have in case of regular fulfilment of the obligation to pay the purchase price that included discharge by means of set-off.¹²⁸ The Court indicated that set-off might be precluded in the case of other guarantees, in particular performance guarantees, since these might serve the liquidity function of providing the beneficiary with readily available funds for curing defects.¹²⁹

C. Tentative conclusions

86. It is submitted that the deliberations of the Working Group need not necessarily aim at finding acceptable solutions to the above questions of invalidity, voidability or unenforceability; primary consideration should rather be given to the preliminary question of whether issues of that kind should be dealt with at all in the uniform law. It may be recalled that, at the twelfth session of the Working Group, the "suggestion was made that it was a complicated area better left to the existing precepts of general contract law. From the discussion which ensued, it appeared that some aspects of the problem might be more appropriate for treatment in the uniform law than others" (A/CN.9/316, para. 157). For example, "doubts were expressed as to whether the uniform law could deal adequately with problems raised by the presence in national legal systems of 'super-mandatory' principles of law and it was suggested that, at least in this respect, the uniform law should confine itself to the execution of the guarantee. A further suggestion was that the uniform law should indicate certain cases in which national law would remain applicable" (A/CN.9/316, para. 160).

87. Starting with the last suggestion, it is submitted that a general or elaborate reference to other possible objections to payment would be appropriate or even necessary so as to avoid any misunderstanding of the principal rule of the uniform law that a guarantor is obliged to pay upon a demand in conformity with the guaranty letter, unless the fraud exception applies.

88. Turning to the basic question as to whether the uniform law should deal with other objections to payment, or at least some of them, the Working Group might wish to use the following considerations as a general guideline. The Working Group might wish to adopt the approach used in other legal texts emanating from the work of

the Commission and refrain from addressing issues of validity or voidability as mentioned in paragraph 76 or, for example, the issue of impossibility to perform due to insolvency or similar impediments. It might also wish to refrain from addressing issues that, while not extraneous to the subject-matter of the uniform law, do not lend themselves to easy answers acceptable on a worldwide basis, such as the impact of public policy and, in particular, the "super-mandatory" principles of law referred to above (paragraph 86).

89. However, the Working Group might wish to address those issues that are of special relevance to the subject-matter of the uniform law (e.g., foreign exchange control). Certainty and uniformity seem to be particularly needed in respect of those issues where divergent decisions have been rendered or where general rules of law appear not to give due regard to the specific nature of the independent undertaking of the guarantor. It is submitted that the duty to refuse payment of an unenforceable obligation (see paragraphs 77-79 above) and the issue of set-off with claims of the guarantor (see paragraphs 80-85 above) fall into that latter category.

III. INJUNCTIONS AND OTHER COURT MEASURES

90. As indicated by various references in the discussion of the fraud exception (e.g., paragraphs 19-21, 27, 38 and 71), the issue of manifest fraud or abuse is relevant not only in the context of the guarantor's determination on whether or not it should pay the beneficiary but also, and more frequently, in the context of injunctive relief sought by the principal from a court. The principal may seek relief against payment by requesting a court order that would enjoin the guarantor from paying or one that would restrain the beneficiary from demanding payment or from receiving payment; the principal might also try to prevent payment by requesting the attachment of the beneficiary's claim or the blocking of funds.

91. Before discussing the procedural aspects of such court measures, it may be mentioned that the issue of fraud or abuse might be relevant in yet other procedural contexts. For example, the fraud exception may be the subject of an action brought by the beneficiary for wrongful dishonour by the guarantor, including a possible preliminary order to pay, or of a claim for interest or other damages in case of late payment. The fraud exception may also become relevant in court proceedings between the principal and the guarantor where the issue of reimbursement may depend on whether the payment by the guarantor was justified despite allegations of fraud or abuse. Such proceedings may be more complicated where the guarantor paid despite a stop-payment order or where the guarantor obeyed a stop-payment order that was later revised on appeal or rendered obsolete in main proceedings.¹³⁰

¹²⁷*Oberlandesgericht Frankfurt*, 26 June 1984, *Wertpapier-Mitteilungen* 1984, 1021.

¹²⁸*Bundesgerichtshof*, 22 April 1985, *Wertpapier-Mitteilungen* 1985, 685 (this decision related to the same case as the German decisions referred to in notes 124 and 127).

¹²⁹*Von Westphalen*, *ibid.* (note 87) p. 178, takes the view that set-off should be precluded under all such other guarantees since they always serve the liquidity function.

¹³⁰For details see, e.g., *Vasseur*, *ibid.* (note 42) pp. 370-371; *Richter*, *ibid.* (note 46) 284-287; *von Westphalen*, *ibid.* (note 87) p. 293.

A. Injunctions against payment

1. Requirements and other procedural aspects of injunctions in general

92. Most jurisdictions, and certainly all those from which court decisions were reported in the discussion on the fraud exception, provide in their procedural laws for injunctions or similar preliminary measures available in case of urgency (e.g., English "preliminary injunction", French "*ordonnance de référé*", German "*einstweilige Verfügung*", Dutch "*kort geding*", Italian "*provvedimento di urgenza*"). The procedures concerning such measures differ considerably from one country to another, and within federal States often from one jurisdiction to another, in respect of such issues as the expected length of the proceedings and of the effect of preliminary injunctions, the possibility of obtaining *ex parte* injunctions in case of extreme urgency or the admissibility of certain means of evidence (e.g., affidavits).

93. However, for the purposes of the following discussion it suffices to see the similarity of the essential requirements for obtaining injunctions in various jurisdictions. For example, courts in the United States, as mentioned above (paragraph 20), tend to require a showing of probable success on the merits, of the danger of irreparable injury and of a balance of hardships tipping decidedly toward the party requesting the preliminary relief,¹³¹ and sometimes also the existence of a public interest.¹³² Similarly, an injunction in Italy under Article 700 Code of Civil Procedure requires the showing of the probable success on the merits and of imminent and irreparable harm.¹³³ To mention only one more example, an injunction in Germany under Article 935 or 940 Code of Civil Procedure requires the probability of the applicant's right or legal position and of serious harm. In determining irreparable or serious harm, courts tend to take into account the kind of considerations that would be dealt with in common law jurisdictions under such labels as "balance of hardship", "balance of convenience" or "public interest".

94. While injunctions are thus generally known and based on essentially similar requirements in the various jurisdictions, the judicial attitude towards ordering injunctions in favour of principals is far from uniform. As will be seen from the following discussion on the answers of courts to the various requirements in the context of independent guarantees and stand-by letters of credit, the views range from a general denial (recently in Germany) or considerable reluctance (in England) and controversy (e.g., in Switzerland) to a more favourable attitude of varying degrees (in other jurisdictions).

2. Special considerations for stop-payment orders

95. To dispose at the outset of a less difficult issue, one may ask whether an injunction may be granted despite the

fact that the beneficiary has not yet demanded payment. While courts have occasionally refused injunctions in such circumstances as premature, for lack of urgency, it is submitted that the prevailing judicial attitude of permitting injunctions is the preferable view, at least where the beneficiary has announced or threatened to call the guarantee.¹³⁴ The principal's interest in obtaining an early injunction is particularly obvious in those jurisdictions where the guarantor is not obliged to notify the principal of a demand, unless so provided in their agreement (e.g., France,¹³⁵ England¹³⁶; United States, where for that reason so-called notice injunctions were developed¹³⁷). Yet, an early injunction should not be categorically denied even if the guarantor is obliged to notify the principal, as provided for in Article 17 URDG (and discussed in A/CN.9/WG.II/WP.68, paragraphs 61 and 63).

96. Turning now to the basic issue of the judicial treatment of the above essential requirements of an injunction, it may be noted that courts often do not address all the requirements when granting injunctions, and they do so even less when refusing injunctions. Moreover, they frequently present their reasons without attributing them to one or the other particular requirement. As indicated by the bulk of court decisions referred to in the discussion on the fraud exception, the most crucial issue determining the fate of the principal's application for injunctive relief appears to be whether or not the instance of fraud or abuse was shown to be manifest or obvious. As previously mentioned (e.g., paragraphs 19-21, 27, 38 and 71), the emphasis is, in the context of preliminary proceedings, more on the showing to the satisfaction of the court than on the knowledge of the guarantor, as would be crucial for the decision of the guarantor whether or not to pay.

(a) Cause of action based on imminent breach of duty

97. National procedural laws on injunctive relief are essentially in accord with the following statements of English judges: "It is common ground that the Courts can only intervene by way of injunction in order to prevent the alleged breach of a legal duty owed by the defendant to the plaintiff, or by way of ancillary relief required by a party to proceedings who asserts a cause of action against the other party",¹³⁸ "the right to obtain an interlocutory injunction is merely ancillary and incidental to the pre-existing cause of action".¹³⁹ Where the principal applies for a stop-payment order against the guarantor relying on fraud or abuse by the beneficiary, the cause of action could only be a claim against the guarantor to refrain from

¹³⁴E.g. Bertrams, *ibid.* (note 40) pp. 337-338.

¹³⁵Vasseur, *ibid.* (note 42) p. 370.

¹³⁶E.g. *Esal (Commodities) Ltd. Reltor Ltd. v. Oriental Credit*, *ibid.* (note 83), except where there is a course of dealing giving rise to some implied agreement.

¹³⁷E.g. *Stromberg Carlson Corp. v. Bank Melli*, 467 F. Supp. 530 (S.D.N.Y. 1979).

¹³⁸*United Trading v. Allied Arab Bank, C.A.*, [1985] 2 Lloyd's Rep. 559 (per Ackner, L.J.).

¹³⁹*The Siskina, H.L.*, [1978] 1 Lloyd's Rep. 6 (per Lord Diplock).

¹³¹E.g. *Caulfield v. Board of Education*, 583 F. 2d 605 (2d Cir. 1978).

¹³²E.g. *Harris Corp. v. National Iranian Radio and Television*, 691 F. 2d 1344 (11th Cir. 1982); see also Task Force Report (note 4) pp. 69-71.

¹³³E.g. Costa, *ibid.* (note 41) pp. 203-205.

paying in the face of abuse since it would otherwise breach a duty owed to the principal.¹⁴⁰

98. The relevant duty of the guarantor is mostly derived from the reimbursement agreement or similar banking contract with the principal and regarded as a fiduciary duty or an ancillary duty of care.¹⁴¹ The guarantor's duty to protect the principal's financial interest in the case of a manifestly abusive demand by the beneficiary is supported by the consideration that the beneficiary is not entitled to payment since abuse constitutes an inherent limit to its right and turns it into an empty formal legal position.¹⁴²

99. Where, in the case of an indirect guarantee, the principal applies for a stop-payment order against the second bank, the cause of action cannot be based on a contractual duty since no contractual relationship exists between that bank and the principal. Here, a duty of care derived from the tort of negligence may be relevant, as recognized in an English decision: "It is arguable that a bank owes a duty of care to the party ultimately liable at the end of the chain not to pay out on a performance bond if, on the information then available to it, there is clear evidence that the beneficiary's demand is fraudulent, because it is the party at the end of the chain who may have to bear the ultimate loss."¹⁴³

100. The existence of a duty to refrain from payment on an abusive demand has been denied in some decisions by holding that a breach of duty might lie in demanding reimbursement or in debiting the principal's account but not in the act of payment to the beneficiary and that the principal was not adversely affected since the guarantor was not entitled to reimbursement if it paid on a manifestly abusive demand.¹⁴⁴ The additional considerations underlying these decisions relate primarily to the independent nature of the guarantor's undertaking and the position of the bank.

(b) Irreparable harm and balance of convenience

101. The decisions referred to in the previous paragraph emphasize the maxim "pay first, litigate later" and the abstract or independent nature of the guarantor's undertaking and conclude that the guarantor should on its own ("autonomously") decide whether or not to pay, without following instructions by the principal. An injunction

against the guarantor would interfere with a relationship to which the principal is not a party, and an injunction would be contrary to the interests of the beneficiary that is not party to the preliminary proceedings and thus unable to present its case.

102. The above considerations have been advanced by some other courts in support of utmost restraint in the context of preliminary proceedings. For example, an English judge, while not denying the guarantor's duty to refuse payment upon an obviously fraudulent demand, deemed restraining orders as inappropriate since they interfered with the bank's obligations and since the principal, in case of breach of that duty, was protected by a claim for damages against the bank.¹⁴⁵ Additional considerations advanced in other decisions or by commentators include the possible danger to the bank's international reputation, the possibility of retaliatory measures against foreign branches and the possibility of conflicting court decisions abroad.

103. The fact that most courts, including German, Belgian and English courts, do not generally deny the availability of stop-payment orders does not mean that they regard all the above considerations as irrelevant. Depending on the particular circumstances of the case, some of the considerations contributed to decisions rejecting injunctions, particularly in cases of indirect guarantees. However, the considerations were not viewed as justifying a categorical denial of injunctive relief. The essential reason is the same as that noted in respect of the cause of action (paragraphs 99-100 above), namely the incidence of fraud or abuse.

104. In line with the recognition of the fraud exception in substantive law, the independent nature of the guarantor's undertaking cannot present an insurmountable obstacle when it comes to procedural protection. The conformity with substantive law is evidenced by the uniform judicial attitude to disallow any stop-payment order based on instances of the underlying transaction other than those recognized as a basis of manifest fraud or abuse.

105. As regards the position of the bank and any possible adverse effect on its reputation, it is recognized that the guarantor is in a dilemma in that it is torn between fulfilling its undertaking towards the beneficiary and bearing in mind the interests of the principal. However, in the case of manifest fraud or abuse it would not be appropriate and fair to one-sidedly favour the interest of the beneficiary or to grant the guarantor, in support of its reputation, the autonomous power to pay despite liquid proof of the beneficiary's fraud or abuse.¹⁴⁶ As stated by an English judge (see paragraph 23 above), "it cannot be in the interests of international commerce or of the banking industry as a whole" that letters of credit and performance bonds are "misused for the purposes of fraud". Moreover, the reputation of a bank is less affected by a court order enjoining payment than by its own decision not to pay.

¹⁴⁰E.g. Bertrams, *ibid.* (note 40) p. 339; however, Richter, *ibid.* (note 46) pp. 279-280, referring to a Swiss decision (BGE 100 II 151), mentions the possibility of an injunction, based on a cause of action against the beneficiary, against the guarantor as a third party, in particular, since the principal is linked with that third party by a contractual relationship that is closely connected with the underlying transaction.

¹⁴¹E.g. *Landgericht Frankfurt*, 11 December 1979, *Wertpapier-Mitteilungen* 1981, 284; von Westphalen, *ibid.* (note 87) pp. 262, 270.

¹⁴²E.g. *Bundesgerichtshof*, 12 March 1984, *Wertpapier-Mitteilungen* 1984, 684.

¹⁴³*United Trading v. Allied Arab Bank, C.A.*, [1985] 2 *Lloyd's Rep.* 560 (per Ackner, L.J.).

¹⁴⁴*Oberlandesgericht Stuttgart*, 11 February 1981, *Wertpapier-Mitteilungen* 1981, 631; *Oberlandesgericht Frankfurt*, 27 April 1987, *Wertpapier-Mitteilungen* 1988, 1480; similarly, *Tribunal de Commerce de Bruxelles*, 7 November 1988, *Dalloz* 1989 *Somm.* 148.

¹⁴⁵*R. D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.*, Q.B., [1977] 2 *All.E.R.* 862 (per Kerr, J.)

¹⁴⁶E.g. von Westphalen, *ibid.* (note 87) pp. 286-288.

106. As regards the alleged lack of the principal's interest in preventing payment on the ground that it suffers no injury in case of wrongful honour (see paragraph 100 above), the following reasons have been advanced in reply.¹⁴⁷ The principal's harm occurs already before the guarantor asks for reimbursement since the very fact of payment to the beneficiary adversely affects the principal's legal position. For example, where the principal has an account with the guarantor the debiting of that account would reverse the procedural roles of the parties. The principal is in the same disadvantageous procedural position in any proceedings for damages against the guarantor. Above all, if the principal later succeeds in establishing the beneficiary's fraud or abuse but fails to demonstrate the bank's awareness thereof, the principal is left with a loss that could have been avoided.¹⁴⁸

107. As regards the above objection (paragraph 101) that the beneficiary does not participate in the preliminary proceedings on a stop-payment order, it may be noted that at least one court denied the principal's legal interest unless it initiated concurrent preliminary proceedings against the beneficiary,¹⁴⁹ and that it is reportedly the prevailing practice in the Netherlands to seek injunctions against both the guarantor and the beneficiary.¹⁵⁰ While the non-participation of the beneficiary is generally not regarded as a categorical objection to preliminary proceedings against the guarantor, it may become relevant in the context of weighing the evidence presented by the principal. For example, in an English case referred to earlier (paragraphs 23, 49 and 99), the court did not consider itself entitled to draw any strong inference of guilt from the beneficiary's silence since that silence might have been prompted by the understandable desire not to submit to a jurisdiction other than the one stipulated in the underlying transaction.¹⁵¹

B. Restraining orders against beneficiary

108. It is submitted that court orders restraining the beneficiary from demanding or accepting payment or obliging it to withdraw its demand do not give rise to special objections.¹⁵² While the independent nature of the guarantor's undertaking is to be recognized, the above considerations relating to the position of the bank and its relationship with the principal would not apply to such restraining orders.

109. However, two procedural points should be mentioned that arise from the fact that the place of business of the beneficiary is in a country other than that of the principal. Since usually the courts at the place of business or residence of the party against which injunctive relief is

sought are competent for such measures,¹⁵³ it may be doubtful whether a restraining order may be sought in another country; it appears that this is possible, at least in some jurisdictions, where, in line with the above-mentioned procedure (paragraph 107), injunctive relief is sought against the guarantor and the beneficiary as co-defendants.

110. A second point that equally arises in respect of a stop-payment order against a foreign guarantor is whether a court, if competent at all, would refrain from granting an injunction on the ground that its recognition abroad is unlikely. It appears that there exists considerable disparity in procedural laws and the attitudes of courts in various jurisdictions,¹⁵⁴ not only as regards the relevance of foreign recognition to such issues as the principal's legal interest or the balance of convenience but also on specific questions such as whether an injunction may be granted without any sanction that would anyway be unenforceable abroad.¹⁵⁵

C. Attachment and similar measures

111. Principals may seek to prevent the beneficiary from profiting from fraud or abuse by attaching its payment claim against the guarantor. Without going here into details of the different procedural requirements for such measures in different jurisdictions, it may be noted that such attempts have rarely been successful.

112. While the attachment is often refused on the same grounds as a stop-payment order, namely that the principal did not establish manifest fraud or abuse as the basis of its claim the realization of which it seeks to secure by attaching the beneficiary's payment claim or by blocking funds, the more common obstacles in various jurisdictions are of a more basic nature. For example, the principal may be taken, as in the related field of commercial letters of credit, as having impliedly waived any right to prevent the performance of the guarantor's undertaking by means of an attachment,¹⁵⁶ or the principal's application for an attachment may be viewed as necessarily lacking any foundation since the payment claim that it seeks to attach is, based on the principal's own allegations, non-existent or without value or since, based on the same allegations, the principal cannot have any claim for damages against the beneficiary.¹⁵⁷

D. Tentative conclusions

113. It is submitted that the uniform law would not fulfil its task of providing legal certainty and uniformity if it would only deal with the fraud exception in terms of substantive law and not address the matter of injunctions and similar court measures; however, there may be little

¹⁴⁷*Ibid.*, pp. 292-294.

¹⁴⁸E.g. Bertrams, *ibid.* (note 40) p. 345.

¹⁴⁹*Landgericht Dortmund*, 5 April 1988, *Wertpapier-Mitteilungen* 1988, 1695.

¹⁵⁰Bertrams, *ibid.* (note 40) p. 347.

¹⁵¹*United Trading v. Allied Arab Bank, C.A.*, [1985] 2 *Lloyd's Rep.* 565 (per Ackner, L.J.).

¹⁵²E.g. Bertrams, *ibid.* (note 40) p. 338.

¹⁵³E.g. Richter, *ibid.* (note 46) p. 283.

¹⁵⁴E.g. Bertrams, *ibid.* (note 40) pp. 349-350, 360-361.

¹⁵⁵E.g. von Westphalen, *ibid.* (note 87) pp. 305-306.

¹⁵⁶E.g. Vasseur, *ibid.* (note 42) p. 377.

¹⁵⁷E.g. von Westphalen, *ibid.* (note 87) pp. 309-317.

need for dealing with attachments. A first reason may be seen in the fact that, as noted above (paragraph 90), the issue of fraud or abuse is of primary practical relevance in the context of preliminary proceedings. Yet, a second reason, of equal importance, may be seen in the need to address the intricate relationship between elective dishonour by the guarantor and the involvement of courts in ordering injunctions, as alluded to earlier (e.g. paragraph 28) and addressed by Section 5-114 UCC, paragraph 12.

114. In devising appropriate provisions for the uniform law, the Working Group might wish to take into account the following considerations. While one may hesitate to attempt a unification effort in the field of procedural law,

it is submitted that these hesitations should be overcome with a view towards ensuring certainty and uniformity in the use of guaranty letters as truly international instruments. In order to achieve that goal, provisions are required on such issues as the standard of proof and the admissible means of evidence, the cause of action as a basis for injunctions, the considerations determining the danger of serious harm and the balance of convenience or similar factors, the appropriateness of requiring a security from the principal and of envisaging payment into court of the disputed amount. Moreover, issues of court competence and recognition of injunctions need to be addressed, as may be done in connection with the discussion on conflict of laws and jurisdiction (A/CN.9/WG.II/WP.71).

**2. Independent guarantees and stand-by letters of credit:
discussion of further issues of a uniform law:
conflict of laws and jurisdiction: note by the Secretariat
(A/CN.9/WG.II/WP.71) [Original: English]**

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INTRODUCTION

1. The present note on conflict of laws and jurisdiction is the fourth in a series of notes discussing possible issues of a uniform law on independent guarantees and stand-by letters of credit. The third note, also before the Working Group at its fifteenth session, discusses fraud and other objections to payment, injunctions and other court measures (A/CN.9/WG.II/WP.70). The issues discussed in the first note, i.e. substantive scope of uniform law, party autonomy and its limits, and rules of interpretation (A/CN.9/WG.II/WP.65), were considered by the Working Group at its thirteenth session (A/CN.9/330). The issues discussed in the second note, i.e. amendment, transfer,

expiry, and obligations of guarantor (A/CN.9/WG.II/WP.68), were considered by the Working Group at its fourteenth session (A/CN.9/342).

2. The Working Group, at its twelfth session (A/CN.9/316, paras. 163-171), noted that questions of applicable law and jurisdiction were likely to arise in the context of international guarantees and commercial letters of credit. While some doubts were expressed, the Working Group was agreed that the uniform law should address the question of the applicable law, in addition to the determination of its own territorial scope of application. The Working Group also considered the basis and scope of dispute settlement clauses. The Working Group was

divided on whether the uniform law should address the question of court jurisdiction for those cases where the guarantee contained neither an arbitration clause nor a choice-of-forum clause.

3. The Working Group was agreed that the questions relating to applicable law, arbitration and court jurisdiction required further consideration and study. Since difficult issues of conflict of laws were involved, it was suggested that the Secretariat, in its preparatory work, might have cooperative consultations with the Hague Conference on Private International Law.

4. Pursuant to that suggestion, the present note has been prepared in consultation with the Deputy Secretary-General of the Hague Conference.¹ It is based on the considerations and tentative conclusions of the Working Group at its twelfth session and takes into account the discussions of the Working Group earlier at that session (A/CN.9/316, paras. 111-120) on the relevant Articles of the ICC draft Uniform Rules for Guarantees (URG).

I. POSSIBLE RULES ON CONFLICT OF LAWS

A. Distinguished from rule on territorial scope of application

5. At the fourteenth session of the Working Group, it was pointed out during the discussion on draft article 1 of the uniform law that the decision on the territorial scope of application of the uniform law would in some respects depend on whether the uniform law would eventually be adopted in the form of a convention or in the form of a model law. In the latter case the question could be settled by rules on conflict of laws that would probably be included in the model law (A/CN.9/342, para. 16). It may be added that rules on conflict of laws could be included in the uniform law even if it were to be adopted in the form of a convention.

6. Since it is not yet decided whether the uniform law will eventually be adopted in the form of a convention or in the form of a model law, both options need to be kept in mind when considering the appropriateness of including in the uniform law provisions on conflict of laws and, possibly in addition, a rule on the territorial scope of application. In those considerations account should be taken of the difference in purpose and effect between

provisions on conflict of laws and a rule on the territorial scope of application.

7. The effect of a rule on the territorial scope of application, in contrast to provisions on conflict of laws, is limited in two respects. Firstly, the rule covers only those international fact situations that are territorially linked with the respective State, namely the contracting State or States in the case of a convention or the State enacting legislation based on the model law. It is in view of this effect that a rule on the territorial scope of application is less common and appropriate in a model law than in a convention. Secondly, a rule on the territorial scope of application concerns exclusively the provisions of the legal text of which it forms a part.

8. In contrast, a rule on conflict of laws is, firstly, designed for all international fact situations of the relevant subject-matter whether or not they are territorially linked to the State that has adopted that rule. Since those fact situations that are territorially linked to that State are thus included, it would be inappropriate for a model law to contain, in addition to the all-embracing conflict-of-laws rule, a rule on its territorial scope of application. Secondly, a conflict-of-laws rule incorporated in the uniform law would not necessarily be limited to the issues addressed in the uniform law, but would cover all the issues determined by the conflict-of-laws rule itself as the so-called domain or scope of the applicable law.

9. In this connection, it may be recalled that during the review of the then current draft Article 27 of the URG ("Unless otherwise provided in the Guarantee, the applicable law shall be that of the Guarantor's place of business . . .") the treatment of the issue of the applicable law was viewed as incomplete and imprecise, and questions were raised as to which of the relationships involved in a guarantee situation were covered by the Article (A/CN.9/316, paras. 112-113).

B. Relationships to be covered by conflict-of-laws rules

10. As regards the relationships for which conflict-of-laws rules might be included in the uniform law, it seems clear that the focus should be on the relationship between guarantor and beneficiary. That relationship may exist under a direct guaranty letter (issued at the request of a principal) or under an indirect one (issued upon the instructions of an instructing party acting at the request of a principal). Another guarantor-beneficiary relationship to be covered exists between a counter-guarantor and its beneficiary that itself issues a guaranty letter to the ultimate beneficiary. Conflict-of-laws rules for the guarantor-beneficiary relationship would also apply to a confirming guarantor and to guarantors under multiple or syndicated guaranty letters, whereby consideration should be given to whether an express statement to that effect in the uniform law seems necessary. Whether the conflict-of-laws rules for all those types of guarantors can be incorporated in a single provision depends in large measure on whether, failing a choice of law by the parties, the same connecting factor (e.g. guarantor's place of business) would be appropriate for all those types (see paragraphs 22-35 below).

¹The Secretariat wishes to express its gratitude to the Deputy Secretary-General who kindly gave his comments and advice despite his reservations about the inclusion of conflict-of-laws rules in the uniform law, at least if it were to be adopted in the form of a model law. In his view, only a separate convention on the law applicable to bank guarantees and stand-by letters of credit could regulate in sufficient detail the many questions concerning, in particular, the modalities and limits of choice-of-law clauses and the clear delimitation of the scope of the applicable law. In view of the almost uniformly accepted connecting factor (i.e. guarantor's place of business), he regards a regulation of the applicable law as needed and appropriate only if one were to aim, as he proposes, at a different connecting factor which would take into account the overall socio-economic situation of the contractual relationship for which the guarantee was given (see para. 35).

11. The Working Group may wish to consider whether the uniform law should include a conflict-of-laws rule for any other relationship such as that between principal and guarantor, principal and instructing party, instructing party and guarantor (apart from their relationship under a counter-guaranty letter), or issuing guarantor and confirming guarantor, or even the underlying relationship between principal and ultimate beneficiary. If any of those relationships (e.g., that between principal and guarantor) were to be dealt with in the substantive provisions of the uniform law, it would seem appropriate to include a conflict-of-laws rule for that relationship as well. As mentioned earlier (paragraph 8 above), the relationships and issues covered by the conflict-of-laws rule need not coincide with those dealt with in the substantive provisions of the uniform law. However, it might be surprising to see in the uniform law a conflict-of-laws rule for a relationship not dealt with in substantive terms, unless there are special reasons for its inclusion. Such reasons might include the experience of serious conflict-of-laws problems in a given relationship, or the idea of harmonizing the conflict-of-laws rule either for two relationships between the same parties (e.g., counter-guaranty letter and indemnity agreement between instructing party and guarantor; see paragraphs 28-29 below) or even for all above-mentioned relationships so as to embrace the overall socio-economic situation of which the guaranty letter forms a part (see paragraph 35 below).

12. After the Working Group has agreed on the relationships to be covered by conflict-of-laws rules in the uniform law, it may wish to discuss and decide on which law should be applicable and then determine the scope of that law (as discussed in paragraphs 36-43 below).

C. Designation of applicable law

13. As regards the designation of the applicable law, the Working Group was agreed at its twelfth session that the future provisions of the uniform law should be composed of two elements: recognition of party autonomy to choose the applicable law, and determination of the applicable law failing agreement by the parties (A/CN.9/316, para. 164).

14. Those two elements are seemingly contained in the current conflict-of-laws rule of the URDG. Draft Article 27 reads:

"Unless otherwise provided in the Guarantee or Counter-Guarantee, its governing law shall be that of the place of business of the Guarantor or Instructing Party (as the case may be), or if the Guarantor or Instructing Party has more than one place of business, that of the branch which issued the Guarantee or Counter-Guarantee."²

²Revised text of the Uniform Rules for Demand Guarantees, ICC Document No. 460/470-1/19 BIS and 460/470-10/1 BIS of 8 February 1991; this draft text constitutes the most recent version of the earlier ICC draft Uniform Rules for Guarantees that had been reviewed by the Working Group at its twelfth session (A/CN.9/316).

15. However, due to the contractual character of the URDG, the effect of the rule differs considerably from the effect of a provision in the uniform law, even if the two were formulated in identical terms. Since the URDG are contractual rules, the second element does not provide the final determination of the applicable law but merely a supplementary choice (like one in general conditions or standard forms) failing a specific choice by the individual parties. Another difference is that, again due to the contractual character of the URDG, either choice would be subject to a law that provided limits to party autonomy or contained requirements as to the form or modalities of the parties' agreement. In contrast, the uniform law, due to its statutory character, would provide the final determination and could impose any such limits or requirements.

1. Freedom of parties to choose applicable law

16. The Working Group was agreed at its twelfth session that any future rule on party autonomy should take a stand on whether the law chosen by the parties had to have a connection with the guarantee or letter of credit transaction or whether the freedom of choice was unlimited (A/CN.9/316, para. 166). In favour of requiring such a connection, one might refer to certain national laws of common law or civil law tradition that tend to limit party autonomy by requiring a certain connection (e.g., reasonable relation) to the given contractual relationship.³

17. However, the more common and modern attitude is to favour unlimited party autonomy, as evidenced, for example, by the Convention on the Law Applicable to Contractual Obligations (Rome 1980). The first sentence of its Article 3(1) reads: "A contract shall be governed by the law chosen by the parties." This liberal attitude seems particularly convincing in respect of the guaranty letter as an international commercial or financial instrument, irrespective of whether it would be classified as a mutual or unilateral contract or as a specialty of the law merchant. Moreover, as a practical matter, there would seem to be little need for limiting party autonomy since it is highly unlikely that a guarantor would include in the guaranty letter the choice of a law that bore no connection whatsoever to the case.

18. Other points to be considered in preparing an appropriate rule on party autonomy relate to the form and modalities of the choice by the parties. At the twelfth session, attention was drawn to the impact of the concept or nature of the guarantee in that it was difficult to conceive of an agreed choice if the guarantee constituted a unilateral undertaking, even if the guarantor had included the choice-of-law clause as a result of a request or assent by the beneficiary or the principal. It was stated in response that, at least from a practical point of view, the

³Pelichet, *Garanties bancaires et conflits de lois*, *Revue de droit des affaires internationales* 1990, 338 (citing the laws of Portugal, Poland and Spain and referring to case law in the United States and other common law countries).

choice-of-law clause in a guarantee should be given effect without the need for investigating the nature and genesis of the guarantee in question (A/CN.9/316, para. 166). It is submitted that, even from a legal point of view, there is no serious obstacle to giving effect to a choice-of-law clause in a guaranty letter even if the guarantor's undertaking is characterized as unilateral. The choice-of-law clause is, after all, but one of the terms of the guaranty letter and usually not the most important one. It should thus be treated in the same way as the entire guaranty letter the establishment of which has been discussed by the Working Group in the context of draft article 7 (A/CN.9/342, paras. 62-67).

19. Another point to be considered is whether only an express choice should be recognized or whether the choice may be implied or deduced from the terms of the guaranty letter or from surrounding circumstances. The 1980 Rome Convention provides in this regard that "the choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case" (Article 3(1)). In a similar vein, the 1986 Hague Convention on the Law Applicable to Contracts for the International Sale of Goods provides in Article 7(1) that "the parties' agreement on this choice must be express or be clearly demonstrated by the terms of the contract and the conduct of the parties, viewed in their entirety". Its predecessor of 1955 followed a more limited approach by requiring in Article 2 that the choice must be by "an express clause or result without doubt from the terms of the contract".

20. Yet another approach might be that followed, in the somewhat different context of excluding the application of the Convention, by article 6 of the United Nations Convention on Contracts for the International Sale of Goods ("The parties may exclude the application of this Convention . . ."). While not requiring an express clause, such wording could, however, entail uncertainty in two respects. Unlike the sample provisions cited in paragraph 19, it provides no guidance as to which kinds of implied or otherwise non-express choice would be recognized, and it might even be misinterpreted as requiring an express clause. Particularly the latter difficulty might ensue if one were to follow the approach of draft Article 27 URDG ("Unless otherwise provided in the Guarantee . . .").

21. Whichever approach the Working Group may agree on, consideration might be given to including in the uniform law a statement to the effect that any choice-of-law clause found in another relationship (e.g., between principal and guarantor, principal and beneficiary, principal and instructing party or instructing party and guarantor) has no bearing on the issue of the law applicable to the guarantor-beneficiary relationship. Such a statement, while technically unnecessary, might help to underline the independence of the guaranty letter in the context of the conflict of laws. If such a clarifying statement would be deemed useful, it should not be limited to the choice-of-law by the parties but should embrace the determination of the applicable law according to an objective criterion or connecting factor.

2. *Determination of applicable law failing choice by the parties*

22. As regards the possible content of a rule determining the applicable law in the absence of agreement by the parties, it was noted at the twelfth session that the most common solution appeared to be the law of the guarantor's country. It was suggested that the uniform law might follow this approach; however, consideration should be given to whether that solution met the interest of the parties in all circumstances (A/CN.9/316, para. 167).

(a) *Basic criterion: guarantor's place of business*

23. There are hardly any statutes on conflict of laws that deal specifically with bank guarantees or stand-by letters of credit. The 1982 Yugoslav Statute on Conflict of Laws is one such rare case. Its Article 20(17) reads:

"Failing a choice of the applicable law by the parties and unless the circumstances of the case indicate another law, the independent bank guarantee contract is governed by the law of the country where, at the time when the contract is concluded, the guarantor has its place of business."

24. Another example is Article 117 of Switzerland's 1987 Federal Statute on Private International Law which reads:

"1. If no law has been chosen, the contract is governed by the law of the country which it is most closely connected with.

2. The closest connection is presumed to exist with the country where the party that is to effect the characteristic performance has its habitual residence or, if the contract is entered into in the course of a professional or commercial activity, its place of business.

3. The characteristic performance is, in particular:

...

(e) in guarantee or surety contracts, the performance of the guarantor or surety."

25. In most jurisdictions, the same result obtains from conflict-of-laws rules that apply generally to contracts or obligations. While the criteria or concepts differ (e.g., closest connection, characteristic obligation or performance, professional activity, performance or execution of the contract (*lex solutionis*)), the solution in respect of the guarantor-beneficiary relationship is almost uniformly the same: the law of the guarantor's place of business.⁴

26. However, there appears to be less uniformity in respect of the relationship between counter-guarantor and guarantor and in those cases where a correspondent bank is involved as advising bank or paying agent. Those situations, which might call for exceptions or refinements, will be discussed later (paragraphs 28-35 below).

⁴For more details see Pelichet, *ibid.*, pp. 338-345.

27. Wherever the basic connecting factor is appropriate, it needs to be qualified for those cases where the guarantor has more than one place of business. Article 27 URDG provides in that case that the governing law shall be "that of the branch which issued the Guarantee . . ." (see paragraph 14 above). If that solution would be adopted for the uniform law, the term "branch" should probably not be used since it might be misunderstood, at least in the English language, as excluding the guarantor's headquarters or principal place of business. Instead, reference could be made to "that place of business where the guaranty letter was issued".

(b) *Possible refinement for cases involving more than one bank*

28. The Working Group may wish to consider whether the above basic rule needs to be refined for those cases where, in addition to one guarantor, a second bank is involved either as another guarantor or as an advising bank or as a paying agent. The most common case is an indirect guaranty letter that is counter-guaranteed by the instructing party. Since the guarantor and the counter-guarantor/instructing party usually have their place of business in different States, the two guaranty letters would be governed by different laws that might take a different stand, for example, on the effect of expiry dates or other terms determining the conformity of a call by the ultimate beneficiary. Another source of complications might be seen in the fact that a separate indemnity or reimbursement agreement, while serving essentially the same purpose as the counter-guaranty letter, tends to be governed by the law of the issuer of the indirect guaranty letter as the recipient of the instructions, by virtue of conflict-of-laws rules for contracts or for agency.

29. Suggestions for avoiding such complications by applying a single law, such as that of the issuer of the indirect guaranty letter,⁵ have not found wide support, mainly because the application of different laws is viewed as a necessary consequence of the independent nature of the counter-guarantor's undertaking.⁶ While the purpose of that undertaking is to indemnify the issuer of the indirect guaranty letter for its payment upon a conforming demand by the ultimate beneficiary, the law determining the conformity of the demand is only of indirect relevance (as a fact) to the decision about the counter-guarantor's payment obligation under the law applicable to the counter-guaranty letter. Where a separate indemnity or reimbursement agreement exists, the issuer of the indirect guaranty letter would anyway have two causes of action against the counter-guarantor/instructing party with often different content such as the amount of reimbursement. It may be added that any banks desirous of applying a single law may achieve that result by appropriate choice-of-law clauses. Finally, the promulgation of the uniform law and its adoption by many States would go a long way towards reducing any remaining concerns.

30. Turning now to the less frequent situations where an advising bank in a different State is involved as a confirming guarantor, as an advising or notifying bank or as a paying agent, reference may be made to a recent survey of English cases dealing with conflict-of-laws issues relating to commercial letters of credit, stand-by letters of credit and bank guarantees.⁷ The author concluded that there existed a very strong presumption that, except for the relationship between the applicant for the credit and the issuing bank, all aspects of the letter of credit are governed by the law of the place at which the advising bank carries on business; the presumption would not apply if the law of the advising bank was excluded by a choice-of-law clause or by surrounding circumstances.

31. To start with the case where the advising bank confirms the undertaking of the issuing guarantor, the application of different laws might lead to the result that the payment obligation of the issuing guarantor is judged differently from that of the confirming guarantor even if cast in identical terms. Any such difference might be viewed as undesirable in view of the fact that, unlike the case of a counter-guaranty letter, both payment obligations are owed to the same beneficiary. If one were thus to aim at a single law, the above presumption in favour of the law of the advising/confirming guarantor would have the advantage of pointing to the country where payment is most likely to be demanded and of aligning the law of both payment obligations to that most likely governing the inter-bank relationship. However, it may again be pointed out that the application of different laws is a consequence of the independent nature of the undertakings, that banks may avoid that result by appropriate choice-of-law clauses and that the uniform law promises to alleviate remaining concerns.

32. It is submitted that it would be even less appropriate to apply to the undertaking of the issuing guarantor the law of an advising bank that merely advises or notifies the guaranty letter. What might be considered, however, is whether the uniform law should include a separate rule on the law applicable to questions relating to the obligations of an advising bank or at least determine whether those questions fall within the scope of the law applicable to the guaranty letter (see paragraph 38 below).

33. Different considerations may apply in those cases where a second bank is entrusted with receiving and examining a payment demand and paying on behalf of the issuing guarantor. It appears that this situation constituted the essence of those English cases of non-confirming advising banks on which the above presumption in favour of the law of the advising bank was based (in fact, in one of the main cases relied upon in the survey the bank where payment was to be made was not the advising bank⁸). The

⁵E.g. Bertrams, *Bank Guarantees in International Trade* (Amsterdam 1990) p. 380; Richter, *Standby Letter of Credit* (Zürich 1990) p. 98.

⁶E.g. Dohm, *Bankgarantien im internationalen Handel* (Bern 1985) p. 145; Kleiner, *Bankgarantie* (4th ed., Zürich 1990) p. 252.

⁷Schmitthoff, Conflict of laws issues relating to letters of credit: an English perspective, in: *Current Problems of International Trade Financing* (2nd ed. by Ho/Chan, Singapore 1990) pp. 103-114. In the same publication, a critical appraisal of English court decisions, noting their consistent application of the *lex fori*, is presented by Gopal, English courts and choice of law in irrevocable documentary letters of credit (pp. 115-136).

⁸*Power Curber International Ltd. v. National Bank of Kuwait S.A.K.*, C.A. [1981] 2 Lloyd's Rep. 394.

recurrent reasoning was that the place where the bank must perform its obligation under a letter of credit determines the proper law to be applied to the letter of credit.⁹ As was stated in a bank guarantee case concerning an injunction, both from the point of view of the payer and from that of the payee, payment in one country can be a very different matter from payment in another.¹⁰

34. The Working Group may wish to consider whether any conflict-of-laws consequences should be drawn from the apparent importance of the place of payment which, after all, is the place of performance of the main obligation under the guaranty letter. If so, one possibility would be, in line with the above presumption, to declare the law of the place of payment to be the law applicable to the guaranty letter; this could be done either by providing an exception to the basic rule for those rare cases where payment is to be made in a State other than that of the guarantor's place of business or by adopting, in lieu of the above basic rule, a general rule referring to the place of payment since it coincides with that of the guarantor's place of business (and the issuance of the guaranty letter) in all but the most exceptional cases. Another possibility might be to take the issues relating to payment, including receipt and examination of the demand, out of the scope of the law applicable to the guaranty letter and to subject them to another law, namely that of the State where payment is to be made. However, this possibility may be viewed as undesirable in that it would split the rights and obligations under a guaranty letter into two parts governed by different laws.

35. Finally, it may be noted that the thrust of the above presumption was to have a single law govern all relationships in a letter of credit transaction, except for the relationship between the applicant and the issuing bank. In this connection, mention may be made of an even more embracing suggestion. Based on the view that the application of different laws to a socio-economic situation that undeniably forms a whole is regrettable and a possible source of problems, it has been suggested that the underlying transaction and the various bank guarantees should be governed by one and the same law.¹¹ A possible basis for determining that law was seen in Article 4(5) of the 1980 Rome Convention according to which the presumption in favour of the place of business of the party who is to effect the characteristic performance shall be disregarded if it appears from the circumstances as a whole that the contract is more closely connected with another country. It was thus said to be possible to identify a centre of gravity, a socio-economic function of all the contractual relationships which would be the basis for attaching these to a single law.¹² However, even leaving

aside the considerable uncertainty of application of this integral approach, one may here again (see paragraph 29 above) point out that the independent nature of each guarantor's undertaking might be called into question, that parties desirous of applying a single law to the entire transaction network may achieve that result by appropriate choice-of-law clauses, and that the uniform law promises betterment by reducing differences between national laws.

D. Scope of applicable law

36. On the assumption that the Working Group will favour a conflict-of-laws rule that is limited to the relationship between guarantor and beneficiary (including relationships between counter-guarantors, confirming guarantors or syndicated guarantors and their respective beneficiaries; see paragraph 10 above), the following discussion may assist the Working Group in determining the scope or domain of the applicable law. While the issues falling within the scope of the applicable law need not coincide with those issues dealt with in the substantive provisions of the uniform law (see paragraph 8 above), one may use the substantive provisions as a basis for considering the kind of issues that are expected to be dealt with and governed by the applicable law as determined by the conflict-of-laws rule.

37. The applicable law should thus cover the establishment and amendment of the guaranty letter, including the questions of form and of time of effectiveness; however, it would not cover questions relating to the capacity of parties or to the authority of individuals to bind or act on behalf of others. The applicable law would determine the meaning and effect of an expiry clause as well as any other term contained in the guaranty letter. It would also decide on the transferability of the beneficiary's rights, including the discharging effect of the guarantor's payment to a transferee.

38. The applicable law should, in particular, answer the questions arising in the most crucial situation in the life of a guaranty letter, that is, when the beneficiary demands payment. It would govern the assessment of the conformity of the demand with the terms and conditions of the guaranty letter and set the standard of the guarantor's duty to examine the demand, including the regularity of any required documents. As regards the standard of examination, consideration might, however, be given to excluding that issue from the scope of the applicable law for those cases where the examination is to take place in a different State, since document checkers may not be prepared to handle documents under laws other than their own (see paragraph 32 above). The idea of excluding standards of examination from the scope of the applicable law and localizing them has inspired, for example, Article 13 of the 1986 Hague Convention on the Law Applicable to Contracts for the International Sale of Goods ("In the absence of an express clause to the contrary, the law of the State where inspection of the goods takes place applies to the modalities and procedural requirements for such inspection").

⁹E.g. *Offshore International S.A. v. Banco Central S.A.*, C.A. [1976] 2 Lloyd's Rep. 402.

¹⁰The "Bhoja Trader", C.A. [1981] 2 Lloyd's Rep. 258 (per L. J. Donaldson).

¹¹Pelichet, *ibid.* (note 3) pp. 345-348, referring to an earlier proposal by Stoufflet, *L'ouverture de crédit bancaire en droit international privé*, *Clunet* 1966, 582, and Bonelli, *La Convention de Rome du 19 juin 1980 et la loi applicables aux opérations bancaires*, *Revue de droit des affaires internationales* 1985, p. 389.

¹²Pelichet, *ibid.*, p. 347.

39. It is submitted that the applicable law should also govern the question of whether the guarantor's obligations include the duty to notify the principal of a payment demand, in the absence of a clause to that effect in its contract with the principal.¹³ The fact that this question affects the interests of the principal should not be viewed as necessitating its exclusion from the scope of application; after all, the same is true in respect of many other questions relating to the guarantor's obligations, such as examining the conformity of the demand with the terms of the guaranty letter or invoking valid objections to payment.

40. As regards objections to payment, the applicable law would determine the kinds of admissible objections and any limits or requirements for invoking them, although a different law might indirectly become relevant as, for example, in certain cases of manifest abuse or fraud (as discussed in A/CN.9/WG.II/WP.70). It is submitted that the same considerations should apply to the admissibility of a set-off, which is technically not an objection to payment but a modality of paying a recognized claim (as discussed in A/CN.9/WG.II/WP.70). However, certain objections to payment or other requirements affecting payment (e.g., restrictions on currency or foreign exchange or other matters of public policy) might be derived from laws other than the law applicable to the guaranty letter.¹⁴

41. Finally, the applicable law would govern such questions as whether the beneficiary may claim interest in case of late honour or damages in case of wrongful dishonour of its demand. Conversely, it would govern such questions as whether the guarantor has a right to reclaim from the beneficiary its payment in a case of wrongful honour or an amount erroneously paid in excess of the sum owed. Both sets of questions should, irrespective of whether they will be dealt with in the substantive provisions of the uniform law, fall within the scope of the applicable law as determined by the conflict-of-laws provisions of the uniform law.

42. In the light of the above presentation of issues, the Working Group may wish to consider how the scope of the applicable law should be formulated in the future conflict-of-laws rule of the uniform law. One approach, as used in the Yugoslav Statute and the URDG (see paragraphs 14 and 23 above), would be to speak simply of "the law governing the guaranty letter". However, one might doubt whether such a formula would do justice to the complexity of the matter and provide sufficient guidance to those applying the conflict-of-laws rule of the uniform law.

43. Another approach could be inspired by the conflict-of-laws rule in draft article 18 of the Model Law on International Credit Transfers, which describes its scope with the words "the rights and obligations arising out of

a payment order", with an exception for the question whether the actual sender of the payment order had the authority to bind the purported sender.¹⁵ If one were to follow that approach in the uniform law, one could refer to "the rights and obligations arising out of a guaranty letter", with possible exceptions for issues falling outside the scope of the applicable law (e.g., capacity of parties, authority of agents, or, possibly, examination of documents abroad) and with possible clarifications concerning the inclusion of issues that not everyone might expect to fall within the scope of the applicable law (e.g., establishment and amendment, duty to notify principal, set-off against payment demand).

II. JURISDICTION

44. The Working Group may wish to take current draft Article 28 of the URDG as a basis for its consideration of issues relating to the settlement of disputes and, in particular, of jurisdiction. Draft Article 28 on jurisdiction reads:

"Unless otherwise provided in the Guarantee or Counter-Guarantee, any dispute between the Guarantor and the Beneficiary relating to the Guarantee or between the Counter-Guarantor and the Guarantor and relating to the Counter-Guarantee shall be settled exclusively by the competent court of the country of the place of business of the Guarantor or Counter-Guarantor (as the case may be) or, if the Guarantor or Counter-Guarantor has more than one place of business, by the competent court of the country of the branch which issued the Guarantee or Counter-Guarantee."¹⁶

45. As was noted in respect of draft Article 27 URDG (paragraphs 14-15 above), the effect of such a rule differs considerably from the effect of a provision in the uniform law, even if the two were formulated in identical terms. Since the URDG are contractual rules, the reference to the exclusive jurisdiction of the competent court of the guarantor's country constitutes merely a supplementary choice of forum, failing a specific choice by the parties, and either choice would be subject to a procedural law that might establish certain limits or requirements. In

¹³Draft article 18 (A/CN.9/344, annex) reads as follows:

"(1) The rights and obligations arising out of a payment order shall be governed by the law chosen by the parties. In the absence of agreement, the law of the State of the receiving bank shall apply.

(2) The second sentence of paragraph (1) shall not affect the determination of which law governs the question whether the actual sender of the payment order had the authority to bind the purported sender for the purposes of article 4(1).

(3) For the purposes of this article,

(a) where a State comprises several territorial units having different rules of law, each territorial unit shall be considered to be a separate State, and

(b) branches and separate offices of a bank in different States are separate banks."

¹⁶Revised text of the Uniform Rules for Demand Guarantees (note 2).

¹³E.g. von Westphalen, *Die Bankgarantie im internationalen Handelsverkehr* (2nd ed., Heidelberg 1990) p. 330.

¹⁴Von Westphalen, *ibid.* pp. 330-334.

contrast, any provision on jurisdiction in the uniform law would constitute a legislative determination of jurisdiction or lack of jurisdiction of the courts in the State adopting the uniform law. It may be added that, in this respect, a provision as part of the *lex fori* is more limited in scope than a conflict-of-laws rule with its universal scope (see paragraph 8 above).

A. Arbitration or forum clause

46. The proviso in draft Article 28 URDG ("Unless otherwise provided in the Guarantee . . .") does not expressly state whether it embraces only the choice of a court or jurisdiction or, as one may assume, also an arbitration clause. When the Working Group reviewed that proviso in the context of a previous version of the draft Article, a view was expressed that it should be redrafted along the following lines: "Unless arbitration or the competent court is provided for in the Guarantee . . ." (A/CN.9/316, para. 119).

47. It is submitted that the proviso in a rule on jurisdiction should, for the sake of certainty, be formulated along the lines suggested in the Working Group, although arbitration clauses in bank guarantees and stand-by letters of credit appear to be rare, except for syndicated guarantees.¹⁷ While arbitration may not always be appropriate for settling disputes arising under a guaranty letter, in particular as regards urgent decisions and provisional measures of protection, it is up to the parties to make that assessment.

48. As regards the choice of either arbitration or court jurisdiction, the same observations were made, during the twelfth session of the Working Group, as in the context of choice-of-law clauses concerning the uncertain basis of the parties' agreement if the guarantee constituted a unilateral undertaking (A/CN.9/316, para. 169). The response submitted in respect of choice-of-law clauses (paragraph 18 above) should apply here with equal force.

49. What remains to be considered is whether the uniform law, in view of its statutory character, should deal with questions concerning the validity and effect of a choice-of-forum clause, in particular, one that simply refers to the courts of State X or to a specific court located in State X. One may ask, for example, whether such a clause confers exclusive jurisdiction upon the chosen court, irrespective of whether that court would otherwise be competent, or whether it merely confers upon an otherwise not competent court jurisdiction that would concur with that of another court. Another question would be whether the choice-of-forum clause might apply to interim or provisional measures, which may be of special relevance in the context of guaranty letters. It may be noted, in this context, that the 1965 Hague Convention on the Choice of Court provides in Article 6(4) that "every court other than the chosen court or courts shall decline

jurisdiction except . . . for the purpose of provisional or protective measures". Special treatment is accorded to provisional and protective measures also by Article 24 of the Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters (Brussels 1968), which recognizes for such measures the jurisdiction of the courts of a State under its domestic law even if under the Convention the courts of another State would be competent to decide on the substance of the case in the main proceedings. Yet another question may be whether a court chosen for settling disputes within a given relationship might be competent for proceedings involving a third party as co-defendant or addressee of a provisional measure.

50. One may come to the conclusion that these and similar questions relating to choice-of-forum clauses need not be dealt with in the uniform law, taking into account the basic purpose of the uniform law as well as the fact that it would, where adopted, become part of a legal system expected to provide answers to these questions. In respect of some such questions, the situation may, however, be different when it comes to the statutory determination of court jurisdiction failing a choice by the parties.

B. Determination of jurisdiction failing choice by parties

51. At its twelfth session, the Working Group considered whether the uniform law should address the question of court jurisdiction for those cases where the guarantee contained neither an arbitration clause nor a choice-of-forum clause. Under one view, an attempt should be made to agree on an acceptable provision on court jurisdiction. Under another view, the uniform law should not deal with this issue (A/CN.9/316, para. 170). It appears that the divergent views within the Working Group relate to the need or appropriateness of including in the uniform law a rule on jurisdiction at all and not to the particular court jurisdiction, such as the one specified in draft Article 28 URDG.

52. It seems indeed appropriate to confer jurisdiction on the courts of the State where the guarantor has its relevant place of business (in line with the basic connecting factor for the conflict-of-laws rule; see paragraphs 23-27 above). As reported in an extensive survey of case law in many countries, "beneficiaries and second issuing banks have invariably brought proceedings for payment in the (first) bank's domicile, which is universally recognized as a proper forum".¹⁸ Jurisdiction of the courts in the State where the guarantor has its place of business is in line with the fundamental principle expressed, for example, in Article 2 of the 1968 Brussels Convention (" . . . persons domiciled in a Contracting State shall, whatever their nationality, be sued in the courts of that State"). It would often be justified on the additional basis of the place of performance of the obligation in question (recognized, for

¹⁷E.g., Dohm, *ibid.* (note 6) pp. 143, 146.

¹⁸Bertrams, *ibid.* (note 5) p. 373.

example, as special jurisdiction in Article 5(1) of the 1968 Brussels Convention).

53. However, national rules of jurisdiction based on the same principles may in less frequent cases point to the courts of the beneficiary's country, for example, for proceedings brought by the guarantor against the beneficiary or when the place of payment is in the beneficiary's country. Consideration may thus be given to aiming in the uniform law at exclusive jurisdiction in the guarantor's country, since otherwise the courts in the beneficiary's country would in such cases retain jurisdiction. That aim could be furthered by a rule according to which the courts of any State other than that of the guarantor shall decline jurisdiction unless the parties have chosen its courts. If one were to combine that rule with the positive rule designed for the guarantor's country, a provision in the uniform law to become part of the *lex fori* of the adopting State might be formulated as follows:

"(1) The courts of [this] [a Contracting] State shall exercise jurisdiction only if:

(a) the guarantor has its place of business in the territory of that State, unless the guaranty letter provides for arbitration or for the exclusive jurisdiction of the courts of another State;

or

(b) the guaranty letter confers jurisdiction upon the courts of that State.

(2) The jurisdiction conferred upon the courts of [this] [a Contracting] State by the provisions of paragraph (1) of this article shall be exclusive, unless the guaranty letter contains a non-exclusive choice-of-forum clause."

54. The Working Group may wish to consider refining this provision with a view to clarifying the scope of the court jurisdiction. The provision might, for example, determine whether the jurisdiction conferred by it covers all disputes between the guarantor and the beneficiary (as, e.g., provided for in draft Article 28 URDG) or whether certain types of disputes (e.g. tort claims) would be excluded. As mentioned in the context of choice-of-forum clauses (paragraph 49 above), it might address the question whether the jurisdiction conferred by it extends to provisional measures, and whether jurisdiction would be exercised over a third party, for example, a counter-guarantor or confirming guarantor as co-defendant or as addressee of an injunction.

55. Even if the uniform law would answer all these questions in favour of a wide scope of jurisdiction, the resulting scope of jurisdiction would still be limited and constitute but a segment of the realm of possible court involvement in guaranty letter transactions. The main limiting factor is that the rule on jurisdiction covers only the relationship between guarantor and beneficiary (including that between counter-guarantor and guarantor) and thus leaves out the person most likely to initiate

proceedings, namely the principal (or possibly the instructing party).

C. Possible expansion of rule on jurisdiction to cover principal

56. The Working Group may thus wish to consider broadening the rule on jurisdiction so as to cover at least certain proceedings involving the principal (e.g., injunction enjoining payment by the guarantor or counter-guarantor, restraining orders against the beneficiary or the guarantor under an indirect guaranty letter). Such broadening would increase the usefulness of the rule. However, it would be a complex and difficult task in view of the variety of possible fact situations and the various relationships involved. To mention only a few questions that might have to be addressed, one may ask, for example, whether the courts of the State where an indirect guaranty letter is issued should accept jurisdiction for an application by a foreign principal to enjoin payment; whether the courts of the State of the counter-guarantor may grant such an injunction against the foreign guarantor (second issuing bank); or whether any courts outside the beneficiary's country would be competent to issue restraining orders against the beneficiary and, in particular, whether the courts of the State of the issuer of a direct guaranty letter have jurisdiction over the foreign beneficiary as a co-defendant in proceedings brought by the principal.

57. On such questions of considerable practical importance, national laws and court decisions do not always provide certain, let alone uniform, answers. While that may create difficulties in finding acceptable solutions for the uniform law, it may be taken as supporting the desirability and usefulness of expanding the rule on jurisdiction to proceedings involving the principal. One may point to the fact that, within that expanded scope, the issue of jurisdiction over foreigners is certain to arise since the issuer of an international guaranty letter tends to have its place of business in a State other than that of the principal (in the case of an indirect guaranty letter) or of the beneficiary (in the case of a direct guaranty letter); if the rule on jurisdiction would be limited to the relationship between guarantor and beneficiary, it would be less needed in view of the fact that both parties are often in the same country.

58. Finally, it is submitted that the decision should to a considerable extent depend on whether the uniform law would include provisions on the procedural requirements of injunctions or other court measures (as discussed in A/CN.9/WG.II/WP.70). If such provisions were to be included, an expanded rule on jurisdiction covering the most likely applicant for court measures would complement these provisions and further the same goal, namely to provide a certain and uniform procedural framework. This, in turn, would complement, from the procedural angle, the substantive provisions of the uniform law in their aim of ensuring a level playing field for all parties involved in guaranty letter transactions.